Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

PETER S. VISINC, MICHAEL GRYNBERG, LEROY HIBBITTS, SAJID KALEEM AND PHILIP WEISBURGH, IRA,

Petitioners,

NORTEL NETWORKS CORPORATION, JOHN ANDREW ROTH, WILLIAM F. CONNOR, CHAHRAM BOLOURI AND FRANK DUNN

Respondents.

On Petition for Writ of Certiorari
To The United States Court of Appeals
For The Second Circuit

PETITION FOR WRIT OF CERTIORARI

James P. Bonner
Shalov, Stone
& Bonner, LLP
485 7th Ave., #1000
New York, NY 10008
(212) 239-4350

Dennis J. Johnson
Counsel of Record
Johnson & Perkinson
1690 Williston Road
S. Burlington, VT 05403
(802) 862-0030

Attorneys for Petitioners

QUESTION PRESENTED

Even though: a) Plaintiffs purchased the very security at issue in the claims; b) during the defined class period; c) at prices which were indisputably inflated by Defendants' allegedly false and misleading statements; and d) the stock purchased by Plaintiffs dramatically declined in price when Defendants revealed the truth at the end of the class period, the Court of Appeals for the Second Circuit (the "Second Circuit") held that Plaintiffs lacked standing under Section 10(b) of the Securities Exchange Act of 1934 (the "Securities Exchange Act"), 15 U.S.C. § 78j, and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, because "[s]tockholders do not have standing to sue . . . when the company whose stock they purchased is negatively impacted by the material misstatement of another company, whose stock they do not purchase." The question therefore presented by this petition is:

> whether a purchaser of a security alleged to have been artificially inflated by Defendant's statements lacks standing under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder because the Defendant is not the issuer of the security which was purchased.

LIST OF PARTIES

The Plaintiffs ("Plaintiffs" or "Petitioners") are purchasers of the common stock of JDS Uniphase Corporation ("JDSU") during the period January 18, 2001 through February 15, 2001 (the "Class Period").[1] ¶ 31 (A-18) The Defendants are Nortel Networks Corporation ("Nortel" or the "Company"); John Andrew Roth, Nortel's Chief Executive Officer, President, and a Director of the Company at all material times; Frank Dunn, the Company's Chief Financial Officer throughout the Class Period; and Clarence J. Chandran, Nortel's Chief Operating Officer at all material times. ¶¶ 3, 32-35 (A-11, 18).[2]

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[1] Citations in this format are to the paragraphs of the Complaint, and, unless otherwise noted, to the Appendix below.

[2] On October 16, 2001, the district court consolidated, for the purposes of discovery, the instant case with a companion case brought against the Defendants by purchasers of Nortel securities. The district court denied Defendants' motion to dismiss the Nortel stock purchaser class action, finding that the plaintiffs had adequately alleged Defendants' scienter and that Defendants' statements, including those at issue in the instant case, were actionable. *In re Nortel Networks Corp. Sec. Litig.*, 238 F. Supp. 2d 613 (S.D.N.Y. 2003). The caption below also references the following plaintiffs in the Nortel class action, though they are not parties to this Petition: Ontario Public Service Employees Union Pension Trust Fund; Eli Weinstein, M&G Investment Management Ltd., and AXA Investment Managers, U.K., Ltd., on behalf of all others similarly situated.

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OPINION BELOW

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STATEMENT OF JURISDICTION

The Court has jurisdiction under 28 U.S.C. § 1254(1). The Opinion was entered on May 19, 2004. Rehearing, timely requested, was denied on July 14, 2004.

APPLICABLE STATUTORY AND REGULATORY PROVISIONS

The text of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j, and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, are reprinted at App. 50a and App. 52a, respectively. The text of Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. § 78c(a)(10) is reprinted at App. 49a. The text of Section 18 of the Securities Exchange Act, 15 U.S.C. § 78r, is reprinted at App. 51a.

STATEMENT OF THE CASE

Petitioners are purchasers of the common stock of JDSU during the Class Period. Plaintiffs allege that Defendants engaged in a fraudulent scheme designed to allow Nortel: (a) to acquire JDSU's "pump laser" business (the "Laser Business") with inflated Nortel stock; and (b)

to complete a $1.5 billion offering of Nortel debt securities. ¶¶ 4-5, 187-207 (A-11, 62-67).

Nortel's false and misleading statements not only inflated Nortel's stock, but also JDSU's. By the start of the Class Period, the market was aware that Nortel and JDSU had reached an agreement in principal for the sale of the Laser Business and Nortel would likely transfer *$2.5* to *$3.0 billion* of its stock to JDSU in exchange for that business. ¶¶ 7, 12, 54, 121-23 (A-12-13, 24, 41-42). Given the efficient market for JDSU's stock, JDSU investors factored this potential asset, which equaled 10% to 12% of JDSU's total assets at that time, into their assessment of JDSU's stock price.[3] Moreover, JDSU investors were aware that Nortel was also JDSU's largest customer, supplying 10%-15% of JDSU's total revenues, and that Nortel's statements regarding the status of its end-user fiber optic business provided critical information for assessing the demand for JDSU's fiber optic components. ¶¶ 6, 12, 123 (A-11, 13, 41-42). The quest for such information was, at that point in time, keen, given market rumors of a potential slowdown in the fiber optic field. ¶ 56 (A-25).

As a result, throughout the Class Period, Defendants' positive statements concerning Nortel's operations and prospects had a direct inflationary impact upon the market price of JDSU stock. When Nortel announced, on the first day of the Class Period, continued strong demand for its products and that it would report earnings and revenue growth of 30% for the year, JDSU's stock price rose $6.56 per share, a rise attributed by market pundits to Nortel's disclosures. *See* ¶¶ 12, 128 (A-13, 43).

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[3] In its Form 10-Q for the quarter ended December 30, 2000, JDSU reported assets of $24.945 billion. Thus, the $2.5 billion in Nortel stock received by JDSU in February 2001 equaled 10% of JDSU's reported assets, and the $3.0 billion in total consideration to be received by JDSU in connection with the transaction equaled 12% of those assets. Relying upon *Kramer v. Time Warner, Inc.*, 937 F.2d 767, 774 (2d Cir. 1991), Petitioners asked the Second Circuit to take judicial notice of the Form 10-Q in resolving their appeal.

On February 6, 2001, when Defendants announced the final terms of the Laser Business transaction and that Nortel would pay JDSU $2.5 billion in Nortel stock and would either make significant future purchases of JDSU products or pay JDSU as much as $500 million more in Nortel stock, JDSU's stock price rose $1.81 per share. ¶¶ 15, 134-38 (A-14, 44-46), ¶¶ 17, 139 (A-14, 46).[4]

On February 12, 2001, when Nortel and JDSU announced the closing of the Laser Business transaction, ¶¶ 19-20, 94 (A-15, 33), which was subject to the "customary closing conditions", one of which was the selling company's attestation that it was unaware of any material change to its operations or financial prospects. ¶¶ 15, 19, 135, 137, 140 (A-14, 15, 44-45, 46). The consummation of this transaction further confirmed to JDSU investors the potential appreciation of what was then one of JDSU's principal assets, $2.5 billion in Nortel stock and a commitment for a material amount of increased future purchases of JDSU's products. ¶¶ 136, 143-44 (A-45, 47).

Having achieved the objective of their fraud, Defendants revealed, just *three days* after the Laser Business transaction closed, that: (a) in contrast to their prior guidance of a profit of 16 cents per share in the first quarter, Nortel would lose 4 cents per share; (b) Nortel's revenues for the quarter would be $1.7 *billion* less than projected at the beginning of the Class Period, just four weeks earlier; (c) Nortel's revenue growth for the year would be 15%, not the 30% previously announced; (d) Nortel's earnings growth for 2001 would be 10% rather than 30%; and (3) Nortel would be cutting 10,000 jobs. ¶¶ 22-23, 157 (A-16, 51).

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[4] Defendants and analysts noted that these revenue commitments represented an increase in Nortel's purchases from JDSU, ¶¶ 16, 144-45, 150 (A-14, 47, 49), and would enhance JDSU's ability to meet its existing projections for fiscal 2001. ¶¶ 16, 144-45 (A-14, 47).

The stunning revelations that the $2.5-$3.0 billion in Nortel stock received by JDSU was worth far less than that amount and that Defendants had vastly overstated Nortel's prospects, prompted a $9.31 per share decline in the market price of JDSU stock to $35.81, a one-day decline of 21%, ¶¶ 24, 163 (A-16, 55), on volume of 99 million shares, making it the most actively traded NASDAQ stock. ¶¶ 24 (A-16).

Numerous analysts immediately lowered their ratings on JDSU stock and specifically noted that their revised guidance and the decline in JDSU's stock price were directly caused by Nortel's revelations. ¶¶ 164-68 (A-55-56). Various analysts questioned the credibility of Defendants' prior statements and flatly rejected Defendants' contention that they had just learned of the slow down in Nortel's business. ¶¶ 161(a)-(e) (A-52-54). Likewise, JDSU indicated that it was "shocked" by Nortel's belated announcements, ¶¶ 170-72 (A-56-57), and informed investors that it understood why analysts cut their JDSU forecasts in response to Nortel's disclosures. ¶ 169 (A-56). While JDSU indicated that it would consider filing suit against Nortel as a result of the Laser Business transaction, it further indicated that it would probably not be able to do so, given the business relationship between the two companies. ¶ 170 (A-56-57).

Plaintiffs' Amended Complaint, filed on January 4, 2002, alleged claims under Section 10(b) of the Exchange Act and Rule 10b-5 on behalf of JDSU purchasers during the Class Period. Though Defendants' statements were clearly material to JDSU investors, a fact which, given the reaction of JDSU's stock price to such statements, has never been contested by Defendants, the district court found that Plaintiffs did not satisfy the "purchaser/seller" requirement for Section 10(b) claims set out in *Blue Chip Stamps v. Manor Drug Store*, 421 U.S. 723 (1975) because Defendants' statements did not relate to JDSU. App. 26a-28a. Additionally, the district court held that Defendants' statements were not issued "in connection with" Plaintiffs'

purchases since they did not go to the "value" of the stock purchased by Plaintiffs.[5] App. 28a-31a.

The Second Circuit declined to discuss the issue of whether Defendants' conduct or statements were "in connection with" Plaintiffs' purchases and, instead, held that Plaintiffs lacked standing because the company issuing the material statements which artificially inflated the securities purchased by Plaintiffs was not the issuer of the securities purchased by Plaintiffs. To reach this conclusion, the Second Circuit ignored the holding of *Blue Chip*, that a plaintiff has standing if he purchases or sells securities, choosing instead to rely on *Blue Chip's dicta* wherein this Court explained the application of the general rule to the facts of that case. No court since *Blue Chip* was decided almost thirty years ago has ever interpreted this *dicta* as limiting Plaintiff's standing to only those who purchased the securities of the Defendant which issues the alleged false or misleading statements. The Opinion improperly shifts the focus of standing from a plaintiff's conduct (the act of purchasing or selling the security at issue) to the type of defendant issuing the misrepresentations. Whether defendant is a proper defendant is a question falling under the purview of the "in connection with" component of Section 10(b).

Moreover, it is clear that, in this instance, Defendants' statements "relate[d]" to JDSU, since the price of that security fluctuated dramatically in response to Defendants' public statements. In fact, on various occasions, Defendants specifically mentioned JDSU in their false and misleading statements. ¶¶ 136-138 (A-45-46) (press release describing the transfer of $2.5 billion in Nortel stock to JDSU and the increased purchasing requirements "intended to enhance the business relationship between both parties.") Even if *Blue Chip* established the standing requirement that Defendants'

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[5] Prior to the district court's opinion, Plaintiffs brought to the district court's attention *S.E.C. v. Zandford*, 535 U.S. 813 (2002), which noted that neither the SEC nor this Court has ever required that a statement go to the value of a security in order for a defendant's conduct to be "in connection with" a purchase or sale. *Id.* at 820.

statements must relate to the security purchased, which it does not, it is clear that *Blue Chip* confirms, rather than negates, Plaintiffs' standing.

To reach its conclusion, the Second Circuit was forced to rewrite Section 10(b) and Rule 10b-5, which make clear that the statute applies whenever a plaintiff purchases or sells "any security." Disregarding this Court's directive that unambiguous statutory language is to be followed ("any" means any), the Second Circuit, relying solely on a law review article which, upon inspection, does not support its conclusion, interpreted the phrase to mean any *type* of security of the company issuing the statement, that is bond, common stock, etc. The Court's conclusion is particularly untenable given that the Securities Exchange Act defines a "security" to include any type of security, rendering the Second Circuit's interpretation of "any" redundant. The Second Circuit's conclusion also contravenes this Court's pronouncements that the repeated use of the term "any" in Section 10(b) and Rule 10b-5 demonstrates the intention of Congress and the Securities Exchange Commission ("SEC") to broadly proscribe all conduct that could mislead investors.

The Second Circuit further disregarded this Court's exhortations that Section 10(b) is to be applied flexibly so as to promote full disclosure and its application is not limited to garden-variety frauds. In addition, the Opinion undermines an extensive body of Supreme Court and circuit court law directing that the "in connection with" phrase of Section 10(b) is satisfied whenever a defendant's conduct or statements "touch" a plaintiff's purchase or sale. Left unaltered, the Opinion mandates that in the Second Circuit, in any number of instances, defendants' conduct may be in connection with plaintiffs' purchases or sales, yet plaintiff will lack standing to ever reach the issue.

The Second Circuit noted its concern that finding Plaintiffs had standing would open a floodgate of litigation as investors in one company routinely sued

other companies for statements they issue about their companies or industries. Initially, this hypothetical concern finds no basis in history, as Plaintiffs found just *several* cases wherein there was such a close nexus between statements by a defendant which was not the issuer of the security purchased and plaintiffs' purchases of such securities that the "in connection with" component of Section 10(b) was satisfied. Defendants found *no cases* wherein any court had either denied standing or found defendants' statements not to be "in connection with" plaintiffs' purchases because plaintiffs purchased securities which were not those of the company issuing the challenged statements. Here, that nexus is supplied by a pending, and then finalized, transaction wherein JDSU would, and did, acquire 65.7 million shares of Nortel stock, equaling 10-12% of JDSU's total assets. While there is no doubt, here, that Defendants' statements were material to JDSU investors and, thus, "in connection with" their purchases, in the normal course, statements by one company will not be material to investors in the stock of another company. The analysis of the nexus between defendants' statements or conduct and plaintiffs' purchases is one that involves the "in connection with" component of Section 10(b), not whether the plaintiffs have standing to even present their case that defendants' statements artificially inflated the securities they purchased.

The Second Circuit incorrectly compared the Plaintiffs to those in *Blue Chip*. None of the vagarities of proof present in *Blue Chip* are present here, however, since all Plaintiffs purchased the stock at issue in their claims, JDSU. The Second Circuit's sole support for its conclusion, that Plaintiffs would have to orally prove that they relied on the Defendants' statements, ignores the very essence of an efficient market. All material information, not just statements uttered by the issuer of a security, is digested by such a market and reflected in the stock's price.

REASONS FOR ALLOWANCE OF THE WRIT

I. The Second Circuit Has Decided An Important And Recurring Issue - Standing - In a Manner That Creates An Intolerable Conflict With This Court's Prior Opinions And In A Manner Which Will Undermine The Integrity of the Market.

The Second Circuit's Opinion represents one of the most constrictive interpretations ever of the federal securities laws. In the Second Circuit, at least the following types of defendants who have previously come within the purview of the statute and Rule 10b-5 now enjoy immunity from liability: a) brokers who lie to their customers about the securities their clients purchase, since the plaintiffs did not purchase the stock of the brokerage firm; b) accountants issuing false opinions about the financial statements of publicly-traded companies, since plaintiffs did not purchase stock in the accounting firm; c) underwriters who lie about companies they take public since plaintiffs did not purchase the underwriter's stock; and d) since there has never been multiple standards of standing under Section 10(b) for misrepresentation and fraudulent act cases (which was also a basis of (Plaintiffs' claims), any of the other knowing participants in frauds, such as banks. The Second Circuit's Opinion has the potential, literally, to unravel the markets' continuing effort to regain investor confidence.

Interpreting *Blue Chip's dicta* relied on by the Second Circuit as limiting standing to those buying the securities of the company issuing the challenged statements reads out of existence *Blue Chip's* repeated pronouncements that it is the mere act of purchasing or selling securities that confers standing. *No court, since Blue Chip was decided almost 30 years ago, has read the opinion to mean what the Second Circuit read into it. Blue Chip* confirms, not negates, the Plaintiffs' standing.

The factual scenarios under which the Opinion denies investors relief or, alternatively, immunizes wrongdoing is extensive. In addition to those examples set forth above, companies will be encouraged to falsely denigrate their competitors' products, knowing that sellers of the competitors' stock have no standing to sue them, nor would such sellers be able to sue the issuer of the securities sold, since it issued no misrepresentations. Similarly, in a joint-venture between Company A, privately held, and Company B, publicly traded, involving product (or drug) development or testing, Company A could publicly lie at will (even with the secret encouragement of Company B) about the status of such products. Though such statements would likely have a direct inflationary impact on the market price of Company B's securities, purchasers of those securities would be unable to sue either party since they did not purchase Company A's securities and Company B issued no statements. Further, as this case makes clear, Company A, in the process of selling material components or divisions of its business to Company B, can openly overstate the financial condition of such components or divisions without fear of reprisal from purchasers of the securities of Company B, whose securities may well have reflected the false valuation of the acquired component or division.

In *Blue Chip,* this Court held repeatedly only that a plaintiff must purchase or sell securities to have standing under Section 10(b), not that plaintiff must purchase or sell the security of the company issuing the false statement. *See* 421 U.S. at 730 (*Birnbaum* "concluded that the plaintiff class for purposes of a private damage action under Section10(b) and Rule 10b-5 was limited to *actual purchasers or sellers*") (emphasis added); *Id.* at 731-32 (*Birnbaum* "conclu[ded] that the plaintiff class for purposes of Section10(b) and Rule 10b-5 private damage actions is limited to purchasers and sellers of *securities*") (emphasis added); *Id.* at 734 ("When Congress wished to provide a remedy to those *who neither purchase nor sell securities*, it had little trouble in doing so expressly.") (emphasis added); *Id.* at 734 ("[A] putative plaintiff, *who neither purchases nor sells securities* but

sues instead for intangible economic injury such as loss of a non-contractual opportunity to buy or sell, is more likely to be seeking a largely conjectural and speculative recovery in which the numbers of shares involved will depend on the plaintiffs' subjective hypothesis.") (emphasis added); and *Id.* at 735 (the justification for permitting a party deceived by a contract made in violation of the Exchange Act to void such an agreement "is absent when there is no actual *purchase or sale of securities*") (emphasis added).

Blue Chip explained that three classes of potential litigants are prevented by the purchaser/seller requirement from alleging Section 10(b) claims: those who say they would have purchased had they known the truth; those who say they would have sold had they known the truth; and those whose holdings are diminished in value due to some corporate or insider activities. *Id.* at 737-38. Here, Plaintiffs fit none of these categories, nor did the Second Circuit find that they did.[6]

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[6] While the district court held that Plaintiffs allege derivative claims, it is clear they do not. The crux of Plaintiffs' claims is that they were directly injured when they purchased JDSU stock at prices artificially inflated by Defendants' false pronouncements. Those claims are direct and belong solely to the class alleged in Plaintiffs' Complaint. *See, e.g., Kusner v. First Pennsylvania Corp.*, 531 F.2d 1234, 1239 (3rd Cir. 1976) ("If the purchasers can prove they parted with that consideration as a result of material misrepresentations in a prospectus, they may recover a direct action whether or not their interest in the corporation would support a derivative suit."); *Muzinich Co., Inc. v. Raytheon Co.*, No. CV-01-284-5-BLW, slip op. 4 (D. Idaho May 1, 2002) ("The plaintiffs [were] . . . induced to purchase stock by fraud. Raytheon knew that its false statements might be relied upon by investors, and plaintiffs did so. Thus, plaintiffs are suing for their own injury caused by Raytheon's statements.") (A-656); *Powers v. Ostreicher*, 824 F. Supp. 372, 378 (S.D.N.Y. 1993) (direct suit allowed where defendant made a misrepresentation that induced a shareholder to pay an inflated price for his stock). Plaintiffs' claims do *not* involve any indirect injury they may have suffered due to JDSU's acquisition of Nortel stock at inflated prices.

The injury alleged by plaintiffs is one that JDSU did not suffer because it did not purchase its own stock. ¶¶ 12, 17, 26, 55, 221,

Blue Chip did not seek to define what types of particular misrepresentations support a § 10(b) claim or, as the Second Circuit interpreted the opinion, who must issue a misrepresentation before a plaintiff has standing. Such matters present issues properly analyzed as questions of materiality or under the "in connection with" requirement, elements of a Section 10(b) claim not addressed in *Blue Chip*. *See, e.g., Semerenko v. Cendant Corp.*, 223 F.3d 165, 176 (3d. Cir. 2000); *In re Ames Dept. Stores Inc. Stock Litig.*, 991 F.2d 953, 967 (2d Cir. 1993).[7]

Standing defines the universe of people who have suffered the type of injury that allows them to pursue a particular claim. *See, e.g., Blue Chip*, 421 U.S. at 733 ("The longstanding acceptance by the courts, coupled with Congress' failure to reject *Birnbaum*'s reasonable interpretation of the wording of § 10(b), wording which is directed toward injury suffered 'in connection with the purchase or sale' of securities, argues significantly in favor of acceptance of the *Birnbaum* rule by this Court.") When *Blue Chip* noted that investors had standing if they purchased or sold the stock "in question" or "at issue," it was describing the universe of plaintiffs who could allege a Section 10(b) claim, not the type of misconduct that would support such a cause of action. Thus, when this Court concluded that only those investors who allege that they suffered damages as a result of a purchase or sale of the securities "at issue" or "in question" have standing, it was referring to the purchase or sale of the securities at issue or in question in plaintiffs' *claims*, and not to the subject matter of defendants' statements. Here, there is no doubt that it is JDSU stock that is "in question" or "at

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227, 228 (A-5, 6, 17, 24-25, 71, 73). Pursuant to *Blue Chip*, JDSU has no standing to bring the claims asserted by the instant Plaintiffs.

[7] While *Blue Chip* referenced Section 10(b)'s "in connection with" language as support for the proposition that the SEC intended for an investor to make a purchase or sale before liability would attach for a Rule 10b-5 violation, *Blue Chip* does not purport to determine the scope of the "in connection with" requirement. *Blue Chip*, 421 U.S. at 733.

issue" in Plaintiffs' claims because Plaintiffs seek to recover the money they overpaid for such shares due to Defendants' misrepresentations. ¶ 31 (A-18).

This conclusion is bolstered by the text of § 18 of the Securites Exchange Act, 15 U.S.C. § 78r, a statute *Blue Chip* relied upon as support for adopting the purchaser/seller requirement. *See Blue Chip*, 421 U.S. at 735. Section 18 provides that persons who make false statements in documents filed with the SEC are "liable to *any* person . . . who, in reliance upon such statement, shall have purchased or sold *a security at a price which was affected by such statement* . . ." App. 51a, 15 U.S.C. § 78r (emphasis added); *see also Blue Chip*, 421 U.S. at 736. Thus, like Rule 10b-5, the express terms of Section 18 do not limit the potential plaintiffs in a securities fraud action to purchasers of the securities of the issuer who made false representations. As this Court recognized in *Blue Chip*, it would be anomalous to have the scope of liability imposed by express causes of action created by the Securities Exchange Act, such as Section 18, be different than the liability imposed by implied causes of action, such as those for violation of Section 10(b). *See Blue Chip*, 421 U.S. at 736.

The language from *Blue Chip* cited by the Second Circuit is not its holding, but was expressly stated to be this Court's application of the general rule to the facts at hand in that case. Thus, after repeatedly announcing merely that those who refrain from buying or selling do not have standing, and that those who purchase the security "at issue" or "in question" have standing, this Court stated, in *dicta*, that "[t]he virtue of the *Birnbaum* rule [i.e., the purchase/seller requirement], simply stated, *in this situation*, is that it limits the class of plaintiffs to those who have least dealt in the security to which the prospectus, representation or omission relates." *Blue Chip*, 421 U.S. at 747 (emphasis added). Underlying this *dicta* was the fact that the plaintiff in *Blue Chip* alleged that he had read the defendants' prospectus and had it not improperly painted a negative picture of the

defendant corporation's prospects, he would have purchased defendant's stock.

Moreover, the context of this passage from *Blue Chip* cited by the Second Circuit confirms this Court's concern that mere market bystanders may assert unfounded claims:

> The virtue of the *Birnbaum* rule, simply stated, in this situation, is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates. And their dealing in the security, whether by way of purchase or sale, will generally be an objectively demonstrable fact in an area of the law otherwise very much dependent upon oral testimony. In the absence of the *Birnbaum* doctrine, bystanders to the securities marketing process could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a failing market and that unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively golden opportunities to pass.

Id. at 747. Clearly, this Court's focus was upon the verifiability of claims based upon actual purchases and sales, as opposed to speculative and perhaps completely concocted causes of action based upon purchases and sales from which investors supposedly refrained. *Id.* at 734-35.

Plaintiffs' purchases of JDSU stock are the exact type of concrete, ascertainable, events that this Court found eliminates the vagaries of proof addressed in *Blue Chip*. *Id.* at 742 ("The fact of purchase of stock and the fact that sale of stock are generally matters which are verifiable by documentation, and do not depend upon oral recollection, so that failure to qualify under the *Birnbaum*

rule is a matter that can normally be established by Defendant . . ."). The context of *Blue Chip's* use of the word "relates" confirms that the Second Circuit endowed that phrase with significance the term was never intended to possess.[8]

In *Basic*, this Court implicitly rejected the premise upon which the Opinion is grounded: that public statements issued by a company are directed only to specific targeted investors. Ironically, the Second Circuit, in holding that "it is not a bar to a 10b-5 action that the false and misleading statements in a Registration Statement are pertaining to an issue of a security, be it preferred stock, reset note, or debenture, or otherwise, which is not the security purchased", *Ames*, 991 F.2d at 964,[9] and in rejecting the argument that liability cannot attach where defendants' statements were supposedly addressed to "discrete groups of potential purchasers, not issued to the public generally," *Ames*, 991 F.2d at 965, explained:

> in *Basic, Inc.*, the defendants, in response to stock market movements, said there were no ongoing merger discussions or known corporate developments, and the plaintiffs, common stock holders, sold their stock after these denials; in fact, the company had been approached as to a merger, and indeed the merger took place after plaintiffs' sales. *The statements neither had any specific audience nor were related to any specific security, but were*

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[8] Since Defendants' statements were material to JDSU and actually discussed JDSU on occasion, it is also beyond cavil that Defendants' statements "relate[d]" to JDSU's stock.

[9] *Accord Itoba Ltd. v. LEP Group Pk.*, 54 F.3d 118, 123 (2d Cir. 1995) ("[A] Rule 10b-5 action is not barred because a false and misleading statement in an SEC filing pertains to a security that is not the security purchased.").

> *held, on the basis of a fact-specific inquiry, to be material and to permit the application of a rebuttable presumption of reliance, supported in part by the fraud-on the-market theory. Id. at 241-45, 108 S.Ct. at 988-90.* . .while *Basic, Inc.,* addressed the reliance and materiality requirements, rather than the connection requirement, *the fraud-on-the-market theory is premised on the notion that fraud can be committed by any means of disseminating false information into the market on which a reasonable investor would rely.* Because the fraud on the market may taint each purchase of *the affected stock,* each purchaser who is thereby defrauded is defrauded by reason of the publicly disseminated statement. *If such a straightforward cause and effect is not a connection, then the Rule would not punish a particularly effective means of reducing the integrity of, and public confidence in, the securities markets.* The "in connection with" language was chosen in an effort to broaden the reach of the Rule to achieve precisely these aims, *see, e.g., SEC v. Texas Gulf Sulphur,* 401 F.2d at 860-62; it should not be used to defeat them.

Ames, 991.F2d at 967-68 (emphasis added). Here, there is no doubt that the cause and effect test accepted by *Ames* is satisfied. Defendants' false and misleading statements regularly inflated JDSU's stock price.

The Second Circuit's conclusion that the supposed need for oral proof of reliance in this case renders the current situation comparable to that present in *Blue Chip* is contradicted by *Basic,* which held that an efficient market absorbs, and reflects in its price, *all* material information and that plaintiffs satisfy the reliance element of their claim merely by relying on the integrity

of the market price of the security purchased. *Basic*, 485 U.S. at 244-47. *See also In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1977) (". . . efficient markets are those in which information important to reasonable investors . . . is immediately incorporated into stock prices."). Plaintiffs alleged that JDSU's stock traded in an efficient market, ¶¶ 176-77, (A-58-60), and even demonstrated the efficiency of that market by pleading the stock's movement whenever Defendants spoke and how analysts attributed those price movements to Defendants' statements. *See supra.* Plaintiffs need not, therefore, rely on oral proof to satisfy the reliance element of their Section 10(b) claim.

II. The Second Circuit's Interpretation Of Standing Cannot Be Squared With The Text Of Section 10(b) And Rule 10b-5.

Section 10(b) and Rule 10b-5 unambiguously confer standing on purchasers or sellers of "any security." In contravention of *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994), which reaffirmed that, absent ambiguity, courts are obligated to follow the text of Section 10(b), the Second Circuit took an unprecedented reading of Section 10(b), concluding that "any security" actually means *any type* of security of the company issuing the challenged statements, such as a bond, common stock, etc. Had Congress and the SEC, however, intended such a limit on standing they were fully capable of accomplishing that objective. By rewriting this unambiguous phrase ("any" means any), the Second Circuit ignored the clear intent of Congress and this Court's admonition that "[t]hese proscriptions, by statute and rule, are broad and, by repeated use of the word 'any' are obviously meant to be inclusive." *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972).[10]

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[10] The Opinion's sole support for reading "any security" to mean any type of security of the company issuing the statement is a treatise, which merely states that "any security" encompasses all types of securities, even those exempt from registration. The word "any",

Moreover, the Second Circuit's interpretation of "any" is redundant of the definition of "security" included in the Securities Exchange Act. 15 U.S.C. § 78c(a)(10) defines security as "any note, stock, treasury stock, security, future, bond, debenture, . . . , investment, contract, . . . , or, in general, any interest or instrument commonly known as a 'security'." 15 U.S.C. § 78c(a)(10). App. 49a. Congress would not have used the term "any" to connote the same meaning as the word "security", which immediately follows it.

III. The Second Circuit's Limitation Of A Plaintiff's Standing Conflicts With Numerous Decisions Issued By This Court Interpreting The "In Connection With" Clause Of Section 10(b) And Directing That This Statute be Interpreted Flexibly, with a Goal of Promoting Full Disclosure.

The Opinion ignores extensive Supreme Court precedent directing that Section 10(b) is not to be interpreted ". . . technically and restrictively, but flexibly to effectuate its remedial purposes," and should be interpreted to implement a policy of full disclosure. *See Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971); *Affiliated Ute*, 406 U.S. at 151; *Basic*, 485 U.S. at 230; *SEC v. Zandford,* 535 U.S. 813, 819-20, (2002). In the Second Circuit, numerous investors may now have no relief under the federal securities laws even if, as here, they have adequately alleged every element of their Section 10(b) claim.

The Opinion also undermines an extensive body of Supreme Court and circuit court precedent interpreting the "in connection with" component of Rule 10b-5. This Court has held that defendants' conduct or statements are "in connection with" a plaintiff's purchase any time they

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however, not only encompasses different types of securities *but also* any issuer's securities. The Opinion cites no authority for its conclusion that "any" must mean one or the other.

"touch" that purchase, *Bankers Life*, 404 U.S. at 12, and recently reaffirmed that it has repeatedly read "in connection with" "flexibly to effectuate its remedial purposes." *Zandford*, 535 U.S. at 819. *See also U.S. v. Russo,* 74 F.3d 1383, 1391 (2d Cir. 1996) (noting the "expansive approach" adopted by the Supreme Court in interpreting the "in connection with" requirement). The Second Circuit previously held that defendants' statements are "in connection with" plaintiffs' purchases, in an efficient market, whenever those statements are material to investors. *Ames*, 991 F.2d at 964. *Accord In re Carter Wallace, Inc. Sec Litig.*, 150 F.3d 153, 256 (2d Cir. 1998) (wherein "a claim is based on the fraud-on-the-market theory, a straightforward cause and effect test is applied.") (internal quotations and citation omitted). The Opinion permits defendants to accomplish indirectly (through the standing requirement) what this Court and the appellate courts have held they may not do directly (through the "in connection with" requirement). *See, e.g., Zandford*, 535 U.S. at 820; *Ames*, 991 F.2d at 967. That the courts apply a broad reading of "in connection with", and even that defendants' conduct is demonstrably "in connection with" plaintiffs' purchases, will be little comfort to whole categories of investors denied standing.

IV. The Second And Third Circuits Are In Conflict As To Whether A Plaintiff Who Purchased Securities Inflated By Statements Uttered By Other Than The Company Whose Securities Plaintiff Purchased Has Standing.

The Opinion is contrary to the Third Circuit's opinion in *Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000). Relying on the *Ames* materiality test, *Semerenko* held that the district court in that case improperly held that Cendant Corp.'s misrepresentations about Cendant made during a tender offer for *ABI* were not "in connection with" the plaintiffs' purchases of *ABI* stock. *Semerenko,* 233. F.3d at 169, 175-76. (Plaintiffs adequately plead a §10(b) claim even though "[t]he complaint does not allege that any member of the class purchased securities issued by Cendant, or that any

member of the class tendered shares of ABI common stock to Cendant.").

The Second Circuit's effort to distinguish *Semerenko* is legally untenable. The Second Circuit stated that it was not resolving whether a plaintiff's purchase of an acquiree's stock in a tender offer would have standing to sue the acquiror for false statements issued by the acquiror, because it would have to analyze the nexus or importance of the proposed transaction to plaintiff's purchase. This sliding scale of standing (how important the proposed transaction is to plaintiff's reason for buying) has never been accepted by any court and will open a Pandora's box of litigation on a case-by-case basis as to whether plaintiffs have standing based on the status of the defendant. The analysis suggested by the Opinion is, actually, exactly what the "in connection with" analysis is all about: were defendants' statements material to investors and therefore "in connection with" their purchases? Moreover, the Second Circuit accepted that Defendants' statements were material to JDSU purchasers, App. 13a, (wherein the court's holding acknowledges the materiality of the statements), and, thus, "in connection with" Plaintiffs' purchases. *See Ames*, 991 F.2d at 964. In fact, the nexus between Defendants' statements and Plaintiffs' purchases was greater than that of the defendants' statements and plaintiffs' purchases in *Semerenko* since, here, the material asset acquisition was completed while, in *Semerenko,* the merger never came to fruition.

Any factual differences between *Semerenko* and this case go only to whether Defendants' statements were material to such investors. Courts have consistently held that representations made by market participants during circumstances analogous to those presented here, such as uncompleted mergers or tender offers, may be material to investors. *See Basic*, 485 U.S. at 236 ("we therefore find no valid justification for artificially excluding from the definition of materiality information concerning merger discussions, which would otherwise be considered significant to the trading decision of a reasonable

investor, merely because agreement in principal as to price and structure has not yet been reached by the parties on their representations"); *Semerenko*, 223 F.3d at 177 ("It is well established that information concerning a tender offer or a proposed merger may be material to persons who trade in the securities of the target company, despite the highly contingent nature of both types of transactions"). Just as the financial condition of an offeror in a tender offer or merger "is likely material to investors considering purchase of the target company's stock," the financial condition of Nortel, which would determine the current and future value of the 65.7 million shares of Nortel stock that JDSU was to, and did, acquire by selling its Laser Business to Nortel, was material to JDSU investors.

The reason *Semerenko* did not discuss standing is because no court, prior to this case, read *Blue Chip* to mean standing only exists whenever plaintiffs purchase the security of the company issuing the false statements. Instead, it has been universally accepted that plaintiffs have standing whenever they purchase the security at issue in their claims. This fact demonstrates the error in the Second Circuit's conclusion that it is "unreasonable to assume that the [*Semerenko*] Court believed standing to be so clearly established that it did even warrant discussion in the opinion." App. 11a-12a. Respectfully, it is far more unreasonable to assume that the distinguished panel from the Third Circuit wholly missed this purportedly key issue. The Third Circuit analyzed the plaintiffs' claims in the exact same way every other Court has for the last thirty years: so long as plaintiffs purchased the security at issue in their claim, was defendants' conduct "in connection with" plaintiffs' purchases?

V. The Second Circuit's Policy Concerns Are Entirely Speculative.

Upon inspection, the Opinion's constrictive reading of Section 10(b) is premised exclusively on a policy concern that conferring standing in this case would open a

floodgate of litigation. This policy argument, however, has *no* factual support. Absent unique circumstances such as those present here, statements by one company will not be material to investors in another company's stock.

For example, statements by *Boeing* regarding the strength of its business will not typically be material to purchasers of the stock of a conglomerate such as General Electric ("GE"), even assuming plaintiffs are able to adequately allege the statements were false and satisfy all other requirements under the Private Securities Litigation Reform Act. Although Boeing may purchase jet engines from GE, Boeing's statements would pertain to just *one* of GE's customers for a *single* product of *one* of its many subsidiaries. As such, there would not likely be a market reaction to such statements.

Notwithstanding the fact that it has been sixty years since Congress adopted Section 10(b) and the SEC adopted Rule 10b-5, a) Defendants found *no* cases wherein any court had either denied standing or found defendants' statements not to be "in connection with" plaintiffs' purchases because plaintiffs purchased securities which were not those of the company issuing the challenged statements; b) Plaintiffs found just a handful of situations wherein unique factors allowed plaintiffs to meet the "in connection with" requirement when they purchased a security other than the company issuing statements;[11] and c) the district court cited only

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[11] *See Semerenko,* 223 F.3d at 175 (misrepresentations by Cendant about Cendant during a tender offer for shares of ABI stock "in connection with" plaintiffs' purchases of ABI stock); *Muzinich* No. CV-01-284-5BLW, slip op. at 9 (in expressly rejecting the standing argument accepted by the Second Circuit, Court held that plaintiffs' purchases of WGI shares were "in connection with" *Raytheon's* misrepresentations about the value of its subsidiary, which was later sold to WGI) (A-661); *Masnik v. Bolar Pharm. Co., Inc.,* No. 90-4086, 1991 WL 138331, #3-6 (E.D. Pa. July 18, 1991) (Misrepresentations by Bolar executives concerning Bolar's generic competitor to SmithKline's drug were in connection with plaintiffs' sales of SmithKline stock); *Crofoot v. Sperry Rand Corp.*, 408 F. Supp. 1154, 1156-58 (E.D.

several cases holding that plaintiffs who do not buy a security at all or do not buy the security at issue in their lawsuit do not have standing. *See, e.g., Inter-County Res., Inc. v. Med. Res., Inc.*, 49 F. Supp. 2d 682, 683 (S.D.N.Y. 1999) (Plaintiffs must be purchasers or sellers "of the securities *at issue in the claim* . . .") (emphasis added).[12]

The harm to investors and the integrity of the markets which likely will be inflicted by the Opinion far outweighs the hypothetical, wholly unsubstantiated, concern of vexatious litigation. Numerous other safeguards preclude the Second Circuit's policy concerns from coming to fruition. Initially, the fact-intensive "in connection with" requirement provides courts with ample power to dismiss cases where, unlike here, the nexus between investors' injuries and defendants' misrepresentations is unclear. *See, e.g., Semerenko*, 223 F.3d at 175 ("in connection with" requirement must be assessed on a case-by-case basis). While "in connection with" in an efficient market case is satisfied by a showing that defendants' statements were material and materiality is not typically an issue to be decided as a matter of law, courts have not hesitated to do so when plaintiff's pleading is devoid of allegations demonstrating its existence. Moreover, plaintiffs must allege and prove loss causation and must be able to satisfy the PSRLA's pleading requirements pertaining to defendants' scienter. Accordingly, there is no reason to interpret Section 10b and Rule 10b-5 as precluding standing simply because the defendant issuing the challenged statements was not also the issuer of the stock purchased by plaintiffs,

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Cal.1976) (statements by *Sperry Rand* regarding its computer system were "reasonably calculated to influence the investigating public," and were "in connection with" the plaintiffs' purchases of another company's stock since Sperry discussed the sale of its computers to that company). The Opinion would, of course, mandate the denial of standing in each of these cases, demonstrating, once again, the breadth of the Opinion's denial of relief to investors.

12 Here, Plaintiffs' claims pertain to the very security at issue in their claims. Thus, the only law cited by either the lower court or the Second Circuit confirms Plaintiffs' standing.

particularly given that doing so is directly at odds with the text of the statute and this Court's *Blue Chip* opinion.

CONCLUSION

For all the foregoing reasons, Petitioners respectfully request that the Supreme Court grant review of this matter.

Respectfully submitted,

Dennis J. Johnson
Counsel of Record
Johnson & Perkinson
1690 Williston Road
S. Burlington, VT 05403
(802) 862-0030
Attorney for Petitioners

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT, DATED AND DECIDED MAY 19, 2004

United States Court of Appeals,
Second Circuit.
ONTARIO PUBLIC SERVICE EMPLOYEES UNION PENSION TRUST FUND, Lead Plaintiff,
Eli Weinstein, on behalf of himself and all others similarly situated, M & G Investment Management Limited and Axa Investment Managers U.K. Ltd.,
Plaintiffs,
Peter S. Visnic, Michael Grynberg, Leroy Hibbitts, Said Kaleem and
Philip Weisburgh Ira, Plaintiffs-Appellants,
v.
NORTEL NETWORKS CORPORATION, John Andrew Roth, William F. Connor, Chahram Bolouri and Frank Dunn, Defendants-Appellants.
Docket No. 03-7608.
Argued: Nov. 19, 2003.
Decided: May 19, 2004.

Background: Investors in fiber optic supplier brought securities fraud action against telecommunications service provider, which had business relationship with supplier, for misstatements made by provider. The United States District Court for the Southern District of New York, Richard M. Berman, J., dismissed complaint. Investors appealed.

Holding: The Court of Appeals, Pooler, Circuit Judge, held that: investors lacked standing.

Affirmed.

Stockholders do not have standing to sue under Section 10(b) and Rule 10b-5 when company whose stock they purchased is negatively impacted by material misstatement of another company, whose stock they do not purchase. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.
*28 Dennis J. Johnson, Johnson & Perkison (Jacob B. Perkison and James P. Bonner, Shalov Stone & Bonner

LLP, New York, NY, on the brief), South Burlington, VT, for Plaintiffs-Appellants.

Stuart J. Baskin, Shearman & Sterling LLP (Tai H. Park, on the brief), New York, NY, for Defendants-Appellees.

Before: OAKES, POOLER, and WESLEY, Circuit Judges.

POOLER, Circuit Judge.

This case requires us to decide whether an individual has standing to sue a company pursuant to Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, for making a material misstatement when the individual purchased the security of a company other than the one that made the misstatement. Plaintiffs Peter S. Visnic, Michael Grynberg, Leroy Hibbits, Sajid Kaleem and Philip Weisburgh IRA appeal from the May 14, 2003, judgment of the United States District Court for the Southern District of New York (Richard M. Berman, *Judge*), dismissing their complaint *29 with prejudice, pursuant to Fed.R.Civ.P. 12(b)(6). We hold that plaintiffs lack standing under these circumstances and affirm.

BACKGROUND

This is an appeal from a dismissal pursuant to Fed.R.Civ.P. 12(b)(6). The facts that follow are not disputed or are taken from the complaint. *See Scheuer v. Rhodes,* 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974). Nortel Networks Corporation ("Nortel") is a global supplier of telecommunications services while JDS Uniphase Corporation ("JDS") manufactures and supplies fiber optic components. Nortel and JDS had been involved in a number of business relationships, and in January, 2001, Nortel was JDS's largest customer, accounting for 10-15% of JDS's revenues. Both companies are publicly traded and, while they appear to have maintained a healthy business relationship, nothing in the record indicates that the companies shared any management structures.

On January 16, 2001, market analysts and news agencies began reporting that Nortel and JDS were on the verge of consummating a transaction that would transfer JDS's laser business to Nortel, in exchange for Nortel stock. On February 6, 2001, Nortel and JDS confirmed that JDS was selling their laser business to Nortel in exchange for $2.5 billion in Nortel stock and a promise of increased fiber optic component purchases. This announcement, plaintiffs contend, caused the price of JDS shares to increase, as market analysts determined that this transaction would make it more likely that JDS would meet its 2001 financial projections. On February 12, 2001, the transaction closed, and Nortel filed a Form 8-K with the SEC, informing the public that it had completed the deal for $2.5 billion in stock.

Meanwhile, from January 18, 2001, to February 15, 2001, Nortel publicly indicated that it saw strong demand for its fiber optics products and expected 30% growth in revenue and earnings for 2001. Plaintiffs claim that these assertions not only improved the value of Nortel's stock, but that because JDS made optimistic projections for its own business based on Nortel's claims, JDS's stock price reacted positively as well. However, on February 15, 2001, Nortel announced that it was cutting revenue estimates for the quarter by $1.7 billion and that revenue growth would be closer to 15% than 30%. Following this announcement, the value of both Nortel and JDS shares tumbled in heavy trading.

Plaintiffs allege that Nortel had known since at least the third quarter of 2000 that the demand for its products was falling and that it had booked revenue from 2001 during the third and fourth quarters of 2000 in order to meet analyst expectations for 2000. The need to resort to these radical tactics in 2000 did not prevent Nortel from setting lofty goals for 2001 and making representations that the demand for its products was growing. Thus, plaintiffs contend that all of the financial filings and press releases regarding earnings made by Nortel from January 18, 2001, to February 15, 2001, were materially misleading because they incorporated inaccurate accounting results and unfounded projections.

District Court Proceedings

After the dust from Nortel's revenue adjustment settled, a number of Nortel shareholders filed class action lawsuits against the company pursuant to Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5. These lawsuits were consolidated into a single class action lawsuit (the "Nortel Complaint"). In addition, several JDS shareholders filed a class action complaint *30 against Nortel under the same securities laws (the "JDS Complaint"). The JDS Complaint was routed to the judge handling the Nortel Complaint, who consolidated the two actions for motion practice and discovery only.

On April 1, 2002, Nortel moved to dismiss the JDS Complaint for lack of standing pursuant to Fed.R.Civ.P. 12(b)(6). [FN1] After briefing, on January 3, 2003, the district court granted Nortel's motion. Citing *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975) and *Birnbaum v. Newport Steel Corp.,* 193 F.2d 461 (2d Cir.1952), the court held that the JDS shareholders did not have standing because they did not purchase or sell any Nortel stock. In addition, the district court concluded that plaintiffs did not satisfy the "in connection with" requirement of Section 10(b) and Rule 10b-5 as Nortel's statements concerned only its own financial state, not that of JDS.

> FN1. Nortel also moved to dismiss both the JDS Complaint and Nortel Complaint on the basis that neither adequately alleged that Nortel made any actionable misstatements of material fact, or that Nortel acted with the requisite scienter. The district court held that the Nortel Complaint satisfied these requirements and dismissed the JDS Complaint on other grounds.

On May 14, 2003, the district court entered a Final Judgment Order, dismissing the JDS Complaint with prejudice. Plaintiffs now appeal.

DISCUSSION

This Court reviews de novo a district court's Rule 12(b)(6) dismissal of a complaint. *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 161 (2d Cir.2000). In doing so, we must "[accept] all factual allegations in the complaint as true and [draw] all reasonable inferences in the plaintiffs' favor." *Id.*

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq., provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange ... (b) [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j.

In accordance with this mandate, the U.S. Securities and Exchange Commission (the "SEC") adopted a number of rules, most notably Rule 10b-5. 17 C.F.R. § 240.10b-5. Rule 10b-5 provides that it is unlawful "(a) [t]o employ any device, scheme or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." *Id.*

The language of Section 10(b) and Rule 10b-5 does not explicitly create a private right of action. In fact, the legislative history fails to indicate whether Congress even contemplated creating such a right. *31 *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 729-30, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975) (citing Note, Implied Liability Under the Securities Exchange Act, 61 Harv.L.Rev. 858, 861 (1948); A. BROMBERG, SECURITIES LAW: FRAUD--SEC RULE 10b-5 § 2.2(300)-(340) (1968); s. Rep. No.792, 73d Cong., 2d Sess., 5-6 (1934)). Nevertheless, courts long have held that a private right of action was indeed created. See e.g., *Kardon v. National Gypsum Co.,* 69 F. Supp. 512, 514 (E.D.Pa.1946), *Superintendent of Ins. v. Banker's Life & Cas. Co.,* 404 U.S. 6, 13 n. 9, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971). This understanding of Congress' intent supports the conclusion that private enforcement of SEC rules "[provides] a necessary supplement to Commission action." *J.I. Case Co. v. Borak,* 377 U.S. 426, 432, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964).

However, the private right of action is not unlimited. The Supreme Court has explained that "[w]hen we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.... It is therefore proper that we consider, in addition to the factors already discussed, what may be described as policy considerations when we come to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance." *Blue Chip Stamps,* 421 U.S. at 737, 95 S.Ct. 1917. While courts were quick to recognize a private right of action under Rule 10b-5, they were equally quick to set limits on it. Indeed, our court was one of the first to restrict Rule 10b-5's private right of action. In *Birnbaum v. Newport Steel Corp.,* 193 F.2d 461 (2d Cir.1952), a group of Newport Steel shareholders tried to bring suit against their company and its directors pursuant to Rule 10b-5. *Id.* at 462. They complained that one of the directors, who also held a controlling 40% interest in Newport Steel, had broken off merger talks with another steel company and had instead sold his stock to a third steel company in order to realize a control

premium. *Id.* In explaining the transaction to the other shareholders, he told them that merger talks had broken down because of the "uncertain international situation." *Id.* They claimed that this misrepresentation, along with the director's sale of securities was enough to trigger liability under Rule 10b-5. *Id.* We found no standing, holding that Rule 10b-5 "was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities" thus limited the class of plaintiffs who could make use of the Rule. *Id.* at 464.

This restrictive view of standing under Rule 10b-5 was confirmed by the Supreme Court in *Blue Chip Stamps.* In that case, the Supreme Court held that individuals who failed to purchase a stock due to a company's misrepresentation of the value of its stock did not have standing to sue under Rule 10b-5 because they were not purchasers or sellers of the security. *Id.* at 754-55, 95 S.Ct. 1917.

In reaching its conclusion, the Court relied heavily on an analysis of congressional intent. Specifically, the Court found that Section 10(b)(5) of the Exchange Act served the same goal as the Securities Act of 1933, 15 U.S.C. § 77a et seq., which was passed in order to prevent companies from using high pressure sales tactics to intimidate people into buying their securities. *Id.* at 752-53, 95 S.Ct. 1917. The Court reasoned that this intent was not furthered by allowing a cause of action for people who did not buy the securities. *Id.* at 754, 95 S.Ct. 1917.

The Court also noted that "[t]here has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in *32 kind from that which accompanies litigation in general." *Id.* at 739, 95 S.Ct. 1917. Thus, allowing a cause of action for non-purchasers would lead to an unacceptable level of abusive litigation. This problem of abusive litigation was particularly salient in the securities litigation field because actions by non-purchasers brought under Rule 10b-5 rely heavily on oral testimony, making them extremely unpredictable until they reach a jury. [FN2] *Id.*

at 739-745, 95 S.Ct. 1917. Thus, the Court was concerned companies could be forced to settle cases that were not meritorious in order to manage their risk-levels. *Id.*

> FN2. While the Private Securities Litigation Reform Act of 1995, Pub.L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of titles 15 and 18 of the United States Code), was enacted to further limit the problem of potentially abusive securities litigation, it did so without affecting the Court's holding in *Blue Chip Stamps.*

[1] In this case, plaintiffs are quick to point out that they did purchase securities after the alleged misrepresentations took place. However, instead of purchasing securities of the entity that made the alleged misrepresentations, they purchased securities of a company that had a business relationship with the misrepresenter. They claim that they have met the *Blue Chip Stamps* standing requirements because they purchased the security at issue in their lawsuit. They base this argument on the references in Section 10(b) and Rule 10b-5 to fraudulent conduct "in connection with the purchase or sale of *any* security." 15 U.S.C. § 78j (b) (emphasis added), 17 C.F.R. § 240.10b-5 (emphasis added). In plaintiffs' view, the word "any" indicates that the intent of Congress and the SEC was to create universal standing for purchasers of securities, allowing anyone who made use of the markets to sue under Rule 10b-5. They further argue that this interpretation is consistent with the Supreme Court's understanding that Congress intended Section 10(b) to be interpreted flexibly to protect against the ever-evolving nature of securities fraud. *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 151, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972).

[2] Plaintiffs assume that the phrase "any security" includes securities of any company affected in some way by the misrepresentation and not just securities of the company that makes the material misstatements. However, in our view, the phrase indicates that the regulations reach *all types* of securities, and not *any*

affected company's securities. *See* Thomas Lee Hazen, The Law Of Securities Regulation § 12.4 (4th ed.2002) (explaining that Rule 10b-5's "any security" language means that it applies to all types of securities, even those that are exempt from registration). Furthermore, plaintiffs' interpretation of this passage is entirely at odds with the purchaser-seller requirement in *Blue Chip Stamps* that "limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates." *Blue Chip Stamps,* 421 U.S. at 747, 95 S.Ct. 1917.

Plaintiffs attempt to salvage their case by arguing that *Blue Chip Stamps* merely holds that an individual who does not purchase securities cannot sue under Section 10(b) and Rule 10b-5. They contend that *Blue Chip Stamps* has no bearing on the facts of this case, as plaintiffs did purchase securities. While plaintiffs correctly identify the factual context of *Blue Chip Stamps,* the Court's reasoning is nonetheless valuable in analyzing plaintiffs' claim. First, in *Blue Chip Stamps* the Court embraced the *Birnbaum* standing limitations as compatible with the legislative intent of the Exchange Act. *Blue Chip Stamps,* 421 U.S. at 733-34, 95 S.Ct. 1917. The Supreme Court's adoption of *Birnbaum* is *33 particularly significant because, like the plaintiffs in our case, the plaintiffs in *Birnbaum* attempted to stretch the meaning of Rule 10b-5. *Birnbaum,* 193 F.2d at 462. We rejected that view of the statute, and the Supreme Court agreed with our narrow interpretation.

Furthermore, in this case, as in *Blue Chip Stamps,* to allow plaintiffs standing would encourage individuals to engage in potentially abusive litigation. This concern was based in part on the fact that an individual's claim that he did not purchase a security would rest almost exclusively on oral testimony. *Blue Chip Stamps,* 421 U.S. at 743, 95 S.Ct. 1917. Because oral testimony cannot be adequately evaluated until presented to a jury, the Court wanted to protect companies from having to defend and settle cases that relied heavily on that form of evidence. As the Court noted, "the abolition of the Birnbaum rule would throw open to the trier of fact many rather hazy

issues of historical fact the proof of which depended almost entirely on oral testimony." *Id.* Here, oral testimony would play a crucial role in proving that plaintiffs relied on Nortel's financial projections when they purchased JDS's securities. In a case where the plaintiff is bringing an action against the company whose securities he purchased, this testimony is corroborated by his ownership of the company's securities. However, where a plaintiff is bringing an action based on the statements of a company whose securities he did not purchase, "[p]laintiff's entire testimony could be dependent upon uncorroborated oral evidence of many of the crucial elements of his claims and still be sufficient to go to the jury." *Id.* at 746, 95 S.Ct. 1917.

Plaintiffs' also rely on *Semerenko v. Cendant Corp.*, a Third Circuit case. 223 F.3d 165 (3d Cir.2000). In *Cendant*, the American International Group, Inc. ("AIG") and Cendant Corp. ("Cendant") entered into a bidding war to claim majority control over American Bankers Insurance Group, Inc. ("ABI"). *Id.* at 170. AIG initiated the bidding, but Cendant eventually won the war. *Id.* However, before the transaction could be finalized, Cendant announced that it had uncovered some accounting irregularities that would force it to restate its earnings. *Id.* Cendant initially tried to honor its bid for ABI, but as details of its accounting problems surfaced, Cendant eventually withdrew from the transaction. *Id.* at 171. As soon as Cendant cancelled the merger, individuals who had purchased shares of ABI after AIG put the company in play with its initial tender offer filed a 10b-5 class action complaint, alleging that Cendant's misstatement of its financial condition caused the price of the ABI stock they purchased to fall.

The *Cendant* court remanded the case to the district court to determine whether the "in connection with" requirement of Rule 10b-5 had been met. *Id.* at 177-78. Plaintiffs argue that by reaching the "in connection with" requirement, the *Cendant* court implicitly held that the plaintiffs had standing to bring their Rule 10b-5 action. However, the opinion never explicitly addressed the standing requirement of Rule 10b-5, and this limits its

persuasiveness. It is unclear whether the *Cendant* court even considered the standing question and it is unreasonable to assume that the court believed standing to be so clearly established that it did not even warrant discussion in the opinion. Thus, while we take notice of the result in *Cendant*, we do not agree with the plaintiffs that it presents a compelling argument in favor of standing.

Furthermore, *Cendant* is easily distinguishable. In *Cendant*, the purchasers of ABI stock understood that it would be exchanged for another company's stock, *34 and the later purchasers thought that it would be exchanged for Cendant stock. This understanding created a direct link between the value of Cendant's stock and ABI's stock that is not present in this case. Furthermore, because Cendant was in the process of merging with ABI, its representations had a much more direct relationship to the value of ABI's stock than Nortel's statements did to the value of JDS's stock, given that no merger was contemplated between these two companies. While there is a multi-billion dollar transaction involved in both cases, a merger creates a far more significant relationship between two companies than does the sale of a business unit. Thus, while a potential merger might require a different outcome, a question that we leave for another day and about which we express no opinion, what remains clear is that the plaintiffs in this case do not have the necessary standing to proceed in an action under Section 10(b) and Rule 10b-5.

Finally, the district court, in finding that the plaintiffs lacked standing, appeared to conflate the issue of standing with the question of whether the "in connection with" requirement had been met. This is misleading because these are two distinct inquiries. In order for our court to properly reach the merits of the case, including the "in connection with" requirement, we must first find that the parties involved have met the basic requirements of standing. *See Warth v. Seldin,* 422 U.S. 490, 498, 95 S.Ct. 2197, 45 L.Ed.2d 343 (1975). Thus, because we find that the plaintiffs lack standing under Section 10(b), we do not reach the "in connection with" requirement.

CONCLUSION

[3] Stockholders do not have standing to sue under Section 10(b) and Rule 10b-5 when the company whose stock they purchased is negatively impacted by the material misstatement of another company, whose stock they do not purchase. Therefore, we affirm the district court's dismissal of plaintiffs' complaint pursuant to Fed.R.Civ.P. 12(b)(6).

ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK, DATED AND FILED JANUARY 3, 2003

United States District Court,
S.D. New York.

In re NORTEL NETWORKS CORP. SECURITIES LITIGATION

No. 01 Civ. 1855(RMB).

Jan. 3, 2003.

Investors brought putative securities fraud class actions against company and its executives. Investors in second company that sold assets to first company in exchange for stock also brought securities claims against company. On motion to dismiss complaints for failure to state claims or allege fraud with particularity, the District Court, Berman, J., held that: (1) investors in second company did not have securities claims based on alleged misrepresentations about first company's value; (2) investors in first company adequately alleged materiality; (3) alleged "soft" opinions were actionable under allegations; (4) bespeaks caution doctrine did not apply; (5) safe-harbor provision of Private Securities Litigation Reform Act (PSLRA) did not apply; and (6) investors adequately pled scienter by alleging facts indicating recklessness or knowledge of falsity.

Motions granted in part and denied in part.

Investors adequately pled scienter for purposes of Section 10(b) and Rule 10b-5 by alleging facts indicating recklessness, including allegation that executives either knew or should have known that their positive statements about company's "momentum" were false in light of common knowledge within company that major sales orders were headed for serious decline. Securities Exchange Act of 1934, § 10(b) as amended, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

*616 Joshua M. Lifshitz, Peter D. Bull, Bull & Lifshitz, New York City, John Halebian, Wechsler, Harwood, Halebian & Feffer, LLP, New York City, Steven

Schulman, Milberg, Weiss, Bershad, Hynes, LLP, New York City, Mark Smilow, Weiss & Yourman, New York City, for plaintiffs.

Stuart Baskin, Sherman & Sterling, New York City, Mark Allen Strauss, Kirby, McInerney & Squire, New York City, Fred I. Isquith, Wolf, Haldenstein, Adler, Freeman & Hertz, New York City, Marvin L. Frank, Rabin & Peckel, LLP, New York City, Richard A. Speirs, Zwerling, Schacter & Zwerling, LLP, New York City, Marc I. Gross, Pomerantz, Haudek, Block, Grossman & Gross, LLP, New York City, Kenneth A. Elan, New York City, Jules Brody, Stull, Stull & Brody, New York City, Gary S. Graifman, Robert D. Wilkins, Kantrowiz, Goldhamer, & Graifman, New York City, Peter L. Masnik, Kalikman & Masnik, Haddonfield, NJ, Jeffrey Hermann, Cohn, Lifland, Perlman, Herman & Knopf, NJ, James P. Bonner, Salov, Stone & Bonner, New York City, Robert C. Susser, New York City, Brian Berry, CA, Andrew M. Schatz, Hartford, CT, Joseph Weiss, Weiss & Yourman, New York City, Roy J. Jacobs, New York City, Shaye Fuchs, NY, James Bashian, New York City, Laurence Rosen, New York City, Michael J. Kane, Mager, White & Goldenstein, LLP, Philadelphia, PA, for defendants.

DECISION AND ORDER

BERMAN, District Judge.

I. Introduction

This Decision and Order resolves Nortel Networks Corporation's ("Nortel" or "Company") motion(s) to dismiss, pursuant to Rules 12(b) and 9(a) of the Federal Rules of Civil Procedure, a series of purported class actions alleging violations of the federal securities laws, particularly Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j (b), Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, and Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a). The litigation was initiated following the precipitous decline in the value of Nortel's common stock on and after February

16, 2001. [FN1] In this (consolidated) *617 action, purchasers of Nortel common stock and call options ("Nortel Plaintiffs") during the period October 24, 2000 through February 15, 2001 ("Class Period"), filed a Second Consolidated Amended Class Action Complaint ("Nortel Complaint" or "NC") against Nortel as well as John Andrew Roth, Nortel's Chief Executive Officer and President during the Class Period ("Roth"), Clarence Chandran, Nortel's Chief Operating Officer during the Class Period ("Chandran"), and Nortel's Chief Financial Officer during the Class Period, Frank Dunn ("Dunn"). (Roth, Chandran, and Dunn will be referred to as "Individual Defendants." The Individual Defendants, together with Nortel, collectively will be referred to as "Defendants.")

> FN1. Soon after the drop in Nortel's stock, more than two dozen suits were filed against the Company in a number federal district courts. On October 16, 2002, those actions were consolidated here.

In a second purported class action, individuals who purchased the common stock of JDS Uniphase Corporation ("JDSU") during the period January 18, 2001 through February 15, 2001 ("JDSU Plaintiffs" and, collectively with the Nortel Plaintiffs, "Plaintiffs"), allege, as against Nortel and the Individual Defendants, violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 ("JDSU Complaint" or "JC"). [FN2]

> FN2. JDSU, headquartered in both Ontario, Canada, and San Jose, California, designs and manufactures products used in fiber-optic communications. As described *infra,* in February 2001 Nortel purchased one of JDSU's production facilities in exchange for Nortel stock. JC ¶ 5.

Defendants filed their Joint Motion to Dismiss the Nortel and JDSU Complaints on August 15, 2002 ("Def.Mem."). On September 15, 2002, Plaintiffs filed a Joint Memorandum of Law opposing Defendants' motion

("Pl.Mem."). On September 30, 2002, Defendants filed a Reply Memorandum ("Def.Reply"). The Court heard (very helpful) oral argument on December 11, 2002. **For the reasons set forth below, the Court grants Defendants' motion to dismiss the JDSU Complaint and denies Defendants' motion to dismiss the Nortel Complaint.**

II. Background

For the purposes of this motion, the allegations of the Nortel Complaint and the JDSU Complaint are taken as true. *Cooper v. Parsky,* 140 F.3d 433, 440 (2d Cir.1998).

Defendant Nortel is a Canadian corporation and one of the world's largest suppliers of "networking solutions and other services that support the Internet and other public and private data, voice, and video networks using wireless and wireline technologies." NC ¶ 28. Nortel is among the leaders of the Internet and telecommunications industry, which, particularly from 1999 through early 2000, became "very hot" and experienced substantial and rapid growth. NC ¶ 44. During 2000, the Internet and telecommunications sectors began a severe contraction. NC ¶ 45. By the start of the Nortel Plaintiffs' Class Period in October 2000, several of Nortel's largest customers were reducing orders for Nortel products and indicating to Nortel salespeople that orders for 2001 would be (even) lower. NC ¶ 5.

On October 24, 2000, Nortel issued an allegedly false and misleading press release indicating that the Company had experienced "strong growth" for the quarter ending September 30, 2000, and that "[l]eading the growth again this quarter, revenues for our Optical Internet Solutions grew nearly 90% in the quarter compared to the same period last year," ("October 2000 Announcement"). [FN3] NC ¶ 66. The *618 October 24 press release went on to say that "[b]ased on the momentum we have experienced during the first nine months and the strong order backlog, we continue to expect that our percentage growth in 2000 over 1999 will be in the low 40's" and that in 2001 Nortel's

revenue and earnings per share would grow "in the 30 to 35 percent range." NC ¶¶ 67-68. The October 2000 Announcement also included "cautionary language," stating that "[c]ertain information included in this press release is forward-looking and is subject to important risks," and that "results or events predicted in these statements may differ materially from actual results or events." Nortel indicated that:

> FN3. "Despite a substantial $7.3 billion in reported sales and an impressive 42% in reported revenue growth for the third quarter of 2000, Nortel's third quarter financial results were below analysts' expectations." NC ¶ 71.

Factors which could cause results or events to differ from current expectations include among other things: ... the impact of rapid technological and market change; ... general industry and market conditions and growth rates; international growth and global economics conditions, ... the uncertainties of the Internet; ... and the impact of increased provision of customer financing by Nortel Networks. October 2000 Announcement; Attached as Exhibit C to Affidavit of Stuart J. Baskin, dated Aug. 15, 2002 ("Baskin Aff."). [FN4]

> FN4. These comments were also included in Nortel press releases dated November 1, 2000 and December 14, 2000, discussed *infra*.

According to the Nortel Complaint, the results reported in the October 2000 Announcement were materially false and misleading. NC ¶ 76. Specifically, Plaintiffs allege that Nortel did not experience "strong growth" and did not have a "strong order backlog" during the third quarter of 2000, "but rather experienced a material decline in the demand for its products" and "suffered a steady deterioration of sales and revenues in its Enterprise Solutions Group, which historically has accounted for a significant portion of the Company's business." *Id.* Plaintiffs further allege that Defendants' "guidance for 2001 (30-35% revenue growth) would be nearly impossible

to achieve in light of contracting Internet and telecommunications sectors and the fact that defendants planned to improperly sacrifice a substantial portion of Nortel's 2001 revenues by pulling those revenues into 2000." NC ¶ 77.

Plaintiffs allege that Nortel's third quarter results were also materially misstated in the Company's third quarter 2000 Form 10-Q, filed with the Securities and Exchange Commission ("SEC") on November 7, 2000 ("Third Quarter Form 10-Q"). NC ¶ 86. In order, allegedly, to "conceal and temper the impact of the negative market changes on Nortel's business, defendants engaged in a variety of practices which caused Nortel's financial results for the third quarter to be materially enhanced and misstated in violation of Generally Accepted Accounting Principles ('GAAP') and SEC reporting rules." *Id.* For example, Plaintiffs allege that the Third Quarter Form 10-Q overstated the Company's results improperly by recording and reporting revenues from shipments of products, even though Nortel "vendor financed" these shipments by extending credit on 100 percent of the sale price to its customers. NC ¶ 88. According to Plaintiffs, vendor financing allowed customers to make purchases that they could not otherwise have made. "Without the extension of credit and/or infusions of cash from Nortel, these companies would not have had the funds sufficient to make the purchases of Nortel products that they did, and, in many cases, were so cash-poor that *619 they were on the brink of insolvency at the time they purchased Nortel products." NC ¶ 55. Plaintiffs allege that by recognizing revenue from these transactions, Nortel violated GAAP and the Company's own internal revenue recognition guideline policies, presumably because Defendants knew that the customers were unable to pay for the products. NC ¶¶ 89-93.

Another practice that allegedly was used improperly to increase reported revenues, involved "pulling forward" revenue into the third and fourth quarters of 2000. NC ¶ 82. "According to former Nortel employees 'pulling forward' is the practice of recording and reporting revenues from the anticipated sales of products in *later*

quarters in[ ] an *earlier* quarter," i.e., in this case, recognizing in 2000 revenue for anticipated sales in 2001 to 2003. *Id.* Plaintiffs also allege that Nortel improperly recognized revenue based on "letters of intent" rather than formal purchase orders. [FN5] NC ¶ 98.

> FN5. Plaintiffs allege a number of ways in which Nortel improperly boosted revenue in the third and fourth quarters of 2000. "In general, Nortel: (i) improperly used 'vendor financing' to generate hundreds of millions of dollars of illusory revenues; (ii) engaged in a series of improper practices that caused Nortel to recognize hundreds of millions of dollars of revenue; (iii) failed to properly account for hundreds of millions of dollars of uncollectible receivables; and (iv) failed to timely and properly recognize approximately $12.5 billion in impairment losses in connection with four of Nortel's recent Internet and telecommunications acquisitions until the second quarter of 2001, after the end of the class period." NC ¶ 7.

Plaintiffs allege that by September 2000 major Nortel clients, such as Verizon, WorldCom and AT & T, were (significantly) scaling back their business with Nortel and indicating that orders in 2001 would also be significantly reduced. NC ¶ 83-85. Despite these dramatic business difficulties, Plaintiffs allege that on November 1, 2000, Nortel issued another materially false and misleading press release, reiterating its positive outlook for 2000 and 2001 ("November 2000 Announcement"). NC ¶ 119. The November 2000 Announcement quoted Roth as saying that Nortel expected its "percentage growth in revenue and earnings per share from operations in 2000 over 1999 will be in the low 40's." *Id.* Roth further indicated that "[l]ooking forward to 2001, we continue to expect the overall market to grow in excess of 20 percent," and that Nortel expected "to grow significantly faster than the market, with expected growth in revenues and earnings per share from operations in the 30 to 35 percent range" for 2001. NC ¶ 120.

At Nortel's Annual Investor Conference on November 21, 2000, the Individual Defendants continued to offer positive, but allegedly false and misleading, reassurances regarding Nortel's prospects for the fourth quarter of 2000 and for 2001. NC ¶ 125. Roth reiterated that the Company's sales and profits from operations (excluding costs of acquisitions) would grow 30 to 35 percent in 2001. *Id.* Dunn reaffirmed that Nortel expected to meet its revenue projections for the first quarter of 2001. Chandran described the demand for fiber-optics as "inevitable and unstoppable," and predicted 40 percent growth in the optical networking market. NC ¶ 126.

On December 14, 2000, Nortel issued another press release that was "virtually identical to the November 1, 2000 statement, again confirming their previously stated guidance for 2000 and 2001," ("December 2000 Announcement"). NC ¶ 136. Roth was quoted as saying that looking forward to 2001, the Company expected "to grow significantly faster than the market, with anticipated growth in revenues *620 and earnings per share from operations in the 30 to 35 percent range." NC ¶ 137. Plaintiffs allege that the statements contained in the December 2000 Announcement were materially false and misleading when made, in part because Nortel had experienced a decline in demand for the Company's products throughout the fourth quarter and because Defendants knew that Nortel's customers would reduce their orders in 2001. NC ¶ 141 ("defendants knew or recklessly disregarded that in light of significant market changes, Nortel's customers would continue to reduce their orders for Nortel products throughout 2001").

Purchase of JDSU's Zurich Business

By December 2000, the Company was engaged in talks with JDSU regarding Nortel's purchase of JDSU's Zurich, Switzerland pump laser business ("Zurich Business") for approximately $3 billion in Nortel stock. JC ¶ 7. JDSU's Zurich Business "was one of two facilities in the world that manufactured pump lasers, a key component of the most advanced fiber-optic networks." JC ¶ 192. Plaintiffs allege that the Zurich Business purchase was part of

Nortel's strategy of acquiring other telecommunications companies using Nortel's "highly-priced shares as currency." NC ¶ 14. The JDSU Plaintiffs allege that during negotiations between Nortel and JDSU, Nortel provided JDSU with false and misleading information regarding the value of Nortel's stock. JC ¶ 132. On February 6, 2001, JDSU announced the sale of its Zurich Business to Nortel for $2.5 billion worth of Nortel common stock in addition to another $500 million in Nortel stock payable to JDSU if Nortel did not meet certain purchase commitments. [FN6] JC ¶¶ 135-36.

> FN6. On February 8, 2001, Nortel Networks Limited, a wholly owned subsidiary of Nortel, completed an offering of $1.5 billion of 6.125 percent notes which mature on February 15, 2006. NC ¶ 188. Plaintiffs allege the "Defendants were ... motivated to maintain Nortel's stock price at artificially inflated levels in order to receive favorable ratings from credit agencies prior to [the] $1.5 billion bond offering." *Id.*

Nortel issued another allegedly false and misleading press release on January 18, 2001, reporting the Company's results for the fourth quarter and full-year 2000 ("January 2001 Announcement"). Nortel reported that, for the fourth quarter, revenues increased 34 percent, while earnings per share from operations grew 24 percent. NC ¶ 152. Roth was quoted as saying that "the fourth quarter capped a year of exceptional growth, which was in line with our expectations." *Id.*

On February 15, 2001, nine days after the acquisition of JDSU's Zurich Business, Nortel allegedly reversed course and issued a press release dramatically lowering the Company's expectations for the first quarter and fiscal year 2001 ("February 2001 Announcement"). NC ¶ 165. The February 2001 Announcement "dramatically reduced the Company's guidance for 2001 growth in revenues and earnings per share from 30%, as stated less than one month earlier, to just 15% growth in revenues and 10% growth in earnings per share." NC ¶ 166. Nortel indicated

that, among other things, the change was due to a "faster and more severe economic downturn in the United States" and longer than expected delays in spending by Nortel customers. NC ¶ 165. In a conference call with investors following the February 2001 Announcement, Roth said that the change in outlook was due, in part, to the fact that "[f]aced with limited access to capital, many telecommunications companies no longer are buying equipment in anticipation of new voice and data traffic." NC ¶ 168. "The press release also indicated *621 that the Company would be laying off thousands of employees and that the scale back process had already begun." NC ¶ 165. On February 16, 2001, Nortel's stock price dropped almost 34 percent from its price the day before, i.e. from $29.75 to $19.00. NC ¶ 167. JDSU's stock dropped 21 percent that same day. JC ¶ 163. By November 2001, Nortel's quarterly revenue was down more than $3 billion from 2000 and Nortel had cut nearly 28,000 jobs. NC ¶ 174.

III. Standard of Review

"Any Rule 12(b)(6) movant for dismissal faces a difficult (though not insurmountable) hurdle." *Harris v. City of New York,* 186 F.3d 243, 247 (2d Cir.1999). "In reviewing a Rule 12(b)(6) motion, this Court must accept the factual allegations of the complaint as true and must draw all reasonable inferences in favor of the plaintiff." *Bernheim v. Litt,* 79 F.3d 318, 321 (2d Cir.1996). "The issue is not whether a plaintiff is likely to prevail ultimately, 'but whether the claimant is entitled to offer evidence to support the claims.' " *Gant v. Wallingford Bd. of Educ.,* 69 F.3d 669 (2d Cir.1995) (quoting *Weisman v. LeLandais,* 532 F.2d 308, 311 (2d Cir.1976) (per curiam)). "Common sense requires that courts remember the purpose of a pleading--to state a claim and provide adequate notice of that claim. A pleading is not a trial and plaintiffs are not required to marshal their evidence and sustain a verdict at this stage." *Gabriel Capital, L.P. v. NatWest Finance, Inc.,* 122 F.Supp.2d 407, 411 (S.D.N.Y.2000). It has been said that "[t]he motion to dismiss for failure to state a claim is disfavored and is seldom granted." *Bower v. Weisman,* 639 F. Supp. 532, 539 (S.D.N.Y.1986) (citing *Arfons v. E.I. du Pont De Nemours & Co.,* 261 F.2d 434,

435 (2d Cir.1958)).

[1] A Rule 10b-5 plaintiff must comply with Fed.R.Civ.P. 9(b) and plead fraud with particularity, so that defendants have "a reasonable opportunity to answer the complaint and ... adequate information to frame a response." *Ryan v. Hunton & Williams,* 99 Civ. 5938(JG), 2000 WL 1375265, at *6 (E.D.N.Y. Sept. 20, 2000) (quoting *Ross v. A.H. Robins Co.,* 607 F.2d 545, 557-58 (2d Cir.1979)). And, the Private Securities Litigation Reform Act of 1995 ("PSLRA") requires that, "the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1) (1997). "To state a claim under § 10(b) and the corresponding Rule 10b-5, a plaintiff must plead that the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that the plaintiff's reliance on the defendant's action caused injury to the plaintiff." *Ganino v. Citizens Utilities Co.,* 228 F.3d 154, 161 (2d Cir.2000).

IV. Analysis

[2] Defendants seek to dismiss the JDSU Complaint on "standing" grounds. *See* Def. Mem. at 3. Defendants seek to dismiss the Nortel Complaint on the grounds that it (i) fails to allege a misstatement of material fact; and (ii) fails adequately to allege scienter. [FN7] *Id.* The *622 JDSU Plaintiffs argue that they have standing based on the materiality of the Defendants' misleading statements about Nortel and the allegedly related decline in the JDSU stock price. Plaintiffs also argue that the Nortel Complaint adequately alleges "a stream of false reassurances and aggressive earnings guidance," NC ¶ 6, including the October 2000 Announcement, the Third Quarter Form 10-Q, the November 2000 Announcement, the December 2000 Announcement, the January 2001 Announcement, and the February 2001 Announcement. *See* Pl. Mem. at 6. The Nortel Plaintiffs allege that these

misstatements were based, in part, on accounting violations designed to increase Nortel's reported revenue in the third and fourth quarter 2000. *Id.* Plaintiffs also contend that the Nortel Complaint sufficiently pleads scienter through allegations of (both) motive and opportunity and conscious misbehavior or recklessness. Pl. Mem. at 4.

> FN7. Defendants argue that because "plaintiffs have failed to plead either a primary violation of the Act by the individual defendants, or scienter, .. the Section 20(a) [claim] must therefore be dismissed." Def. Mem. at 21 n. 20. "Section 20(a) of the Exchange Act provides that '[e]very person who ... controls any person liable [for a § 10(b) violation] ... shall also be liable jointly and severally with and to the same extent as such controlled person.' " *Ellison v. American Image Motor Co., Inc.,* 36 F.Supp.2d 628, 637 (S.D.N.Y.1999) (citation omitted). The Court does not (here) dismiss the Nortel Plaintiffs' Section 10(b) claim and, therefore, their Section 20(a) claim also survives.

A. Standing of the JDSU Plaintiffs

[3] Defendants persuasively point out that the JDSU Plaintiffs, who held JDSU stock during their class period, neither purchased nor sold Nortel shares and cannot bring a (private) claim under Rule 10b-5. Def. Mem. at 21. "Having neither bought nor sold Nortel securities of any kind, the JDSU plaintiffs seek money damages from Nortel on the ground that its statements about its own business performance and prospects adversely affected JDSU's stock price.... The JDSU plaintiffs' case is foreclosed by the Supreme Court decision of *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), as well as the seminal decision of the Second Circuit in *Birnbaum v. Newport Steel Corp.,* 193 F.2d 461 (2d Cir.1952)." Def. Mem. at 21. Plaintiffs respond that they are purchasers of securities (namely JDSU securities) as defined by *Blue Chip,* and, therefore, have standing. "Because each named JDSU

Plaintiff and the JDSU Class bought JDSU stock during the class period ... the *Birnbaum* purchaser/seller rule is plainly satisfied." Pl. Mem. at 22. [FN8]

> FN8. Plaintiffs argue that "they were injured when they purchased JDSU stock at prices that were artificially inflated by defendants' statements." Pl. Mem. at 22.

[4] In *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), the Supreme Court adopted the *Birnbaum* rule that "the plaintiff class for purposes of a private damage action under s 10(b) and Rule 10b-5 [is] limited to actual purchasers and sellers of securities." [FN9] *Blue Chip,* 421 U.S. at 730, 95 S.Ct. 1917. The question in *Blue Chip* was "whether respondent may base its action on Rule 10b-5 of the Securities and Exchange Commission without having either bought or sold the securities described in the allegedly misleading prospectus." 421 U.S. at 727, 95 S.Ct. 1917. The Court found that the *Birnbaum* rule "limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates." 421 U.S. at 747, 95 S.Ct. 1917.

> FN9. The *Birnbaum* rule refers to the holding of the United States Court of Appeals for the Second Circuit in *Birnbaum v. Newport Steel Corp.,* 193 F.2d 461 (2d Cir.1952).

The JDSU Plaintiffs acquired JDSU shares during their class period. They did not purchase or sell the Nortel securities *623 "to which the prospectus, representation, or omission relates." *See also Holmes v. Sec. Investor Protection Corp.,* 503 U.S. 258, 277, 112 S.Ct. 1311, 117 L.Ed.2d 532 (1992) (O'Connor, J., concurring) ("in *Blue Chip* ... we confirmed the federal courts' 'longstanding acceptance' of the rule that a plaintiff must have actually purchased or sold the securities at issue in order to bring a Rule 10b-5 private damages action") (citations omitted); *Grace v. Rosenstock,* 228 F.3d 40, 46 (2d Cir.2000) ("this Court ruled that no private action under those provisions

is available to persons who were neither buyers nor sellers of the relevant securities") (citation omitted); *Trump Hotels & Casino Resorts, Inc. v. Mirage Resorts Inc.*, 140 F.3d 478, 485 (3d Cir.1998) ("[i]n *Birnbaum* the court ... concluded that Rule 10b-5 'extended protection only to the defrauded purchaser or seller' of the security at issue") (citations omitted); *Inter-County Resources, Inc. v. Medical Resources, Inc.*, 49 F.Supp.2d 682, 683 (S.D.N.Y.1999) ("plaintiff was concededly neither a purchaser nor a seller of the securities at issue in the claim, a basic requirement for standing to bring such a claim"). [FN10]

> FN10. The JDSU Complaint revolves around alleged misrepresentations regarding Nortel securities which the JDSU Plaintiffs never purchased. *See, e.g.*, JC ¶ 10 ("Defendants perpetrated their fraudulent scheme by, among other false pronouncements, repeatedly informing investors that Nortel would see growth in revenue and earnings of 30% during 2001 and that they continued to see 'strong market demand' for Nortel's products.").

Plaintiffs argue (unpersuasively in the Court's view) that the "stock at issue" in this case is JDSU stock. Tr. at 32 ("In our case the stock at issue is JDSU and by virtue of their purchases of JDSU, they plainly and simply satisfied the *Birnbaum* [/] *Blue Chip* doctrine.") "Because defendants' statements were material to JDSU investors, plaintiffs' purchases were in connection with those statements." Pl. Mem. at 23.

[5] The United States Court of Appeals for the Second Circuit has "broadly construed the phrase 'in connection with,' holding that Congress, in using the phrase 'intended only that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities.' " *In re Carter-Wallace, Inc. Secs. Litig.*, 150 F.3d 153, 156 (2d Cir.1998) (quoting *SEC v. Texas Gulf*

Sulphur Co., 401 F.2d 833, 860 (2d Cir.1968) (en banc)). Generally, the requisite connection exists "when the fraud alleged is that the plaintiff bought or sold a security in reliance on misrepresentations as to its value." *In re Ames Dep't Stores Inc. Stock Litig.,* 991 F.2d 953, 966 (2d Cir.1993) (misrepresentations about Ames' business made in that company's reset note and debenture prospectus were issued "in connection with" plaintiffs' purchases of Ames common stock). That connection does not exist where, as here, the plaintiff does not allege that the defendant "misled him concerning the value of the securities he [actually bought or] sold or the consideration he received in return." *Saxe v. E.F. Hutton & Co., Inc.,* 789 F.2d 105, 108 (2d Cir.1986); *see also Production Resource Group, LLC v. Stonebridge Ptns. Equity Fund,* 6 F.Supp.2d 236, 240 (S.D.N.Y.1998) ("the alleged misrepresentations made by defendants were not 'in connection with' the purchase or sale of securities, because they did not pertain to the value, nature or investment characteristics of the securities at issue.")

As Defendants point out, the JDSU Plaintiffs' allegations are the "essence of a *624 derivative claim." Def. Reply at 10 (citing *Burghart v. Landau,* 821 F. Supp. 173, 176 (S.D.N.Y.) *aff'd* 9 F.3d 1538 (2d Cir.1993)). And, while Plaintiffs may be correct that "JDSU may have its own cause of action for its purchase of Nortel shares at an inflated price," Pl. Mem. at 22, the JDSU Complaint is not brought by JDSU or derivatively on its behalf.

Plaintiffs fail to identify an analogous case (from this or another circuit) that allows, in the circumstances presented here, a shareholder of one company to bring a private Section 10(b) or Rule 10b-5 claim against a second company based on alleged misstatements pertaining to the second company's stock. Plaintiffs cite to *Ames,* discussed above, for the proposition that "it is not a bar to a 10b-5 action that the allegedly misleading statements pertain to a security other than the one purchased." Def. Mem. at 23. The instant ruling is consistent with *Ames.* In *Ames,* the court of appeals held that it was improper for the district court to dismiss a case where the plaintiffs were holders of common stock of the same issuer that

allegedly made misrepresentations in connection with its reset note and debenture offering. *Id.* at 961. "[I]t is not a bar to a 10b-5 action that the false and misleading statements in a Registration Statement are pertaining to an issue of a security, be it preferred stock, reset note, or debenture, or otherwise, which is not the security purchased." *Id.* at 964. The *Ames* court did not find, as Plaintiffs contend, that misleading statements of one issuer are actionable by the holders of securities of a different issuer upon the facts presented here.

The Plaintiffs also rely upon the decision of the United States Court of Appeals for the Third Circuit in *Semerenko v. Cendant Corp.,* 223 F.3d 165 (3d Cir.2000). The Court believes that such reliance does not enhance the JDSU Plaintiffs' cause. In *Semerenko,* a case involving competing tender offers, the Third Circuit did not, in fact, resolve the question of "whether the 'in connection with' test [was] satisfied," but ruled only that the district court applied the wrong standard. *Id.* at 177. In analyzing the standard of review employed by the district court, the court of appeals held that alleged misrepresentations by and about one company (Cendant) could be found to have been made "in connection with" the purchase of shares in a different company (ABI) where, among other things, Cendant made fraudulent misrepresentations concerning Cendant's financial condition, and about "its willingness to complete the tender offer, and its willingness to complete the proposed merger." *Id.* at 171. [FN11] Cendant shares may have been at issue because it was "possible that members of the Class would not have purchased shares of ABI common stock had they been unable to exchange them for shares of Cendant." *Id.* at 180. *Semerenko* does not stand for the proposition asserted by Plaintiffs here, i.e. that information regarding the financial condition of Nortel is "material" to the shareholder(s) of JDSU and is sufficient to give rise to the JDSU Plaintiffs' Section 10(b) and Rule 10b-5 claims. [FN12]

> FN11. In *Semerenko,* Cendant was competing against AIG, Inc. to purchase the outstanding shares of ABI, eventually bidding the tender offer

price up from $47 per share to a final price of $67 per share. *Id.* at 171. Cendant signed a merger agreement with ABI and made a number of public statements indicating that "it was committed to completing the merger with ABI." *Id.* at 170. Cendant thereafter abandoned its tender offer plans; it terminated the merger agreement with ABI and agreed to pay ABI a $400 million break-up fee. *Id.* at 171.

FN12. Plaintiffs also cite to an unpublished opinion from the United States District Court for the District of Idaho, *Muzinich & Co. v. Raytheon Co.*, No. CV-01-284-S-BLW, slip op. at 2-3 (D.Idaho May 1, 2002), in support of the proposition that "statements issued about one company or its securities can, indeed, be 'in connection with' plaintiffs' purchases or sales of another security". Pl. Mem. at 25. In *Muzinich,* unlike the case at bar, it was alleged that the defendant "knew that these false financials would be included in WGI's Form 10-K filings with the [SEC], and that investors would rely on the Form 10-Ks." *Muzinich,* slip op. at 2.

*625 **B. Misstatements of Material Fact**

Defendants argue that the Nortel Complaint, consisting of 209 paragraphs and 88 pages, fails to identify any (actionable) material misstatements made during the Class Period. Def. Mem. at 5. Defendants contend that the misstatements alleged fall into three categories: (i) factually accurate statements of historical fact, Def. Mem. at 7; (ii) expressions of "soft opinion" and "puffery", Def. Mem. at 7; and (iii) forward looking statements accompanied by suitable cautionary warnings. Def. Mem. at 9. Plaintiffs argue that the Nortel Complaint sufficiently alleges that Defendants' statements of both historical results and predictions of future financial performance were materially misleading. Pl. Mem. at 5. Plaintiffs also claim that some of Nortel's forward looking statements are actionable because they were not

accompanied by sufficient cautionary language and Defendants did not have a reasonable basis for believing that Nortel's predictions were accurate. Pl. Mem. at 16.

1. Historical Statements

Plaintiffs allege that the historical results reported in Nortel's October 2000 and January 2001 Announcements and the Third Quarter Form 10-K were materially misstated, among other reasons, because of various "accounting irregularities perpetrated at Nortel." Pl. Mem. at 5. Plaintiffs contend that these irregularities included improper revenue recognition, failure to account for uncollectible receivables, and GAAP violations relating to the impairment of assets and caused Nortel's third quarter, fourth quarter and year-end 2000 results to be materially (over) enhanced and misleading. *See, e.g.,* NC ¶ 163 ("As in the 2000 third quarter, in order to conceal the impact of the significant contraction of the Internet and telecommunications markets on Nortel's business, defendants engaged in a number of accounting improprieties which caused the Company's results for the year-end 2000 (as reported by defendants on January 18 and 19, 2001) to be materially enhanced and misstated in violation of GAAP and SEC reporting rules.").

Defendants argue that because "Nortel's 2000 results were so stellar, and understandably provided the context for its own ... expectations for 2001, plaintiffs have no choice but to plead that the results were not real." Def. Mem. at 11. That is, Defendants contend that Nortel's results for the third and fourth quarters of 2000 were not misstated and that Plaintiffs' allegation(s) of accounting improprieties must "fail as a matter of law." *Id.* Defendants argue that Plaintiffs have neither plead the alleged accounting improprieties with the requisite specificity, nor have the Plaintiffs adequately plead the materiality of the alleged misstatements. Def. Mem. at 12; *see also* Transcript of Dec. 11, 2002 Oral Argument ("Tr.") at 50 ("they plead all of these accounting standards which are the accounting standards and then if you look at it, your Honor, you will not find a single fact, other than Verizon, not a single particularized event other than

Verizon, to try to apply those standards").

a. Accounting Allegations are Adequately Specific

[6] [7] "The complaint must identify the statements plaintiff asserts were fraudulent *626 and why, in plaintiff's view, they were fraudulent, specifying who made them, and where and when they were made." *In re Scholastic Corp. Secs. Litig.,* 252 F.3d 63, 69-70 (2d Cir.2001). "A statement made in violation of GAAP may be found to be misleading or inaccurate under the federal securities laws." *SEC v. Caserta,* 75 F.Supp.2d 79, 90 (E.D.N.Y.1999); *see also In re Quintel Entertainment Inc. Secs. Litig.,* 72 F.Supp.2d 283, 293 (S.D.N.Y.1999) ("Although 'allegations of a violation of GAAP provisions, without corresponding fraudulent intent are not sufficient to state a securities fraud claim,' if the Complaint alleges additional evidence of intent, a violation of GAAP may be the basis of a § 10(b) claim.") (citation omitted).
[8] The Nortel Complaint alleges a number accounting practices that may have inflated improperly the Company's (reported) revenues during the third and fourth quarter of 2000 including: improper recognition of revenue from sales based upon letters of intent rather than formal purchase orders, NC ¶ 98; failure properly to reflect (through reserves or charges against income) the risk of "noncollectibility" of unsecured loans extended to uncreditworthy customers, NC ¶ 108; and failure to recognize "billions of dollars" in impairment losses on long-term assets obtained through the Company's acquisitions. NC ¶ 113. [FN13] The Nortel Complaint specifically alleges that the Company improperly reported revenue on sales where Nortel extended 100 percent vendor-financing to customers, with the knowledge that those customers could not pay for the product(s). NC ¶ 92. Plaintiffs contend that revenue from these sales were "known to be materially uncollectible" and that recording that revenue violated Nortel's "internal revenue recognition policies, which, according to Nortel's Form 10-K for the fiscal year ended December 31, 2000, required collection to be 'reasonably assured' prior to recognition." NC ¶ 93. Plaintiffs allege that this practice led to recording improperly "hundreds of millions, if not billions,

of dollars" in revenue. NC ¶ 92. These allegations, if true, are more than a mere "contention that Nortel extended unwise loans." Def. Mem. at 12. They provide a (sufficiently) detailed account of "why, in plaintiff's view [the challenged statements] were fraudulent." *Scholastic,* 252 F.3d at 69. *See also Quintel Entertainment,* 72 F.Supp.2d at 293 ("These allegations sufficiently plead that the financial reports were false or misleading statements, subject to the requirements of materiality and scienter, discussed below.").

> FN13. Defendants do not appear to challenge a number of alleged GAAP violations, including improperly recognizing revenue where "Nortel shipped interim or substitute products and booked revenue as though the final products had been shipped," NC ¶ 100, and improperly recognizing revenue on the sale of new products prior to the expiration of the allowable date of return. NC ¶ 101.

b. Accounting Allegations are Material

[9] Defendants contend that the alleged accounting improprieties are (individually) immaterial in light of Nortel's $30 billion in reported revenue for 2000. Def. Mem. at 12 ("In this case the [materiality] bar is high, as Nortel had $30 billion in 2000 revenue."). Plaintiffs respond that the alleged misstatements, taken as a whole, are "plainly material." Pl. Mem. at 20. "In Nortel's press releases, conference calls with analysts and periodic SEC filings, Nortel: (i) reported hundreds of millions, if not billions of dollars in false revenues (¶¶ 88-102); (ii) failed to timely and properly recognize $12.5 billion in impairment losses from certain of its acquisitions (¶¶ 113-18); and (iii) overstated the *627 Company's reported assets by failing to account for hundreds of millions, if not billions, of dollars in wholly uncollectible receivables (¶¶ 103-12)." *Id.* (emphasis excluded).

"At the pleading stage, a plaintiff satisfies the materiality requirement of Rule 10b-5 by alleging a statement or

omission that a reasonable investor would have considered significant in making investment decisions." *Ganino,* 228 F.3d at 161. "The determination of materiality is a mixed question of law and fact that generally should be presented to a jury." *Press v. Chem. Inv. Servs. Corp.,* 166 F.3d 529, 538 (2d Cir.1999). A complaint should not be dismissed "on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Goldman v. Belden,* 754 F.2d 1059, 1067 (2d Cir.1985); *see Ganino,* 228 F.3d at 162.

"[A]llegations of materiality should not be considered in isolation." *Manavazian v. Atec Group, Inc.,* 160 F.Supp.2d 468, 478 (E.D.N.Y.2001) Rather, "whether an alleged misrepresentation or omission is material necessarily depends on all relevant circumstances of the particular case." *Ganino,* 228 F.3d at 162. Looking at all of the alleged accounting improprieties in the Nortel Complaint, the Court cannot conclude, as a matter of law, that they are "so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Goldman,* 754 F.2d at 1067; *see also In re Revlon, Inc. Secs. Litig.,* 99 Civ. 10192, 2001 WL 293820 at *9 (Mar. 27, 2001) ("A bill and hold transaction here, an improperly delayed customer credit there, 'and pretty soon you're talking about real money.' ") (citation omitted).

2. "Soft-Opinion"

[10] Defendants argue that Nortel's "statements of prediction, hope, opinion or belief about its own future performance are not actionable under Rule 10b-5." Def. Mem. at 7. Plaintiffs respond that the purported statements of "soft-opinion" are actionable because "defendants made specific and consistent misrepresentations, based on purported contemporaneous facts, regarding Nortel's expected revenues, earnings and earnings per share for fiscal year-end 2000 and fiscal 2001, and that each of those statements was made with

defendants' actual knowledge or reckless disregard based upon adverse contrary facts." Pl. Mem. at 16-17 (citation omitted).

[11] "Statements regarding projections of future performance may be actionable under Section 10(b) or Rule 10b-5 if they are worded as guarantees or are supported by specific statements of fact, or if the speaker does not genuinely or reasonably believe them" *In re International Business Machines Corp. Sec. Litig.,* 163 F.3d 102, 107 (2d Cir.1998) (citations omitted). Here, Plaintiffs have alleged that Defendants did not genuinely or reasonably believe that the purportedly "soft" statements were true. The November 2000 Announcement, for example, quoted Roth as saying:

> Looking forward to 2001, we continue to expect the overall market to grow in excess of 20 percent. Given our strong market position and leadership in high performance Internet solutions, we continue to expect to grow significantly faster than the market, with anticipated growth in revenues and earnings per share from operations in the 30 to 35 percent range.

*628 NC ¶ 120. [FN14] The Nortel Complaint, however, explicitly alleges: that Defendants did not believe that the market would grow in excess of 20 percent; that the Internet and telecommunications markets experienced a significant contraction in the third quarter of 2000; and that it would be "nearly impossible" for Nortel to achieve 30 to 35 percent revenue growth in 2001, NC ¶ 123. *See Gabriel Capital,* 122 F.Supp.2d at 419 ("Thus, plaintiffs have alleged that SDI did not genuinely or reasonably believe that Mini-Mill was 'first class' when it made that statement.").

> FN14. Defendants contend that this statement is nothing more than a prediction or hope for the future and is "not actionable as a matter of law." Def. Mem. at 8.

Several of Nortel's alleged misstatements were not simply "soft" predictions; rather, they contained recitations of (allegedly inaccurate) historical facts. In the October 2000 Announcement, for example, Roth stated: "Based on the momentum we have experienced during the first nine months and the strong order backlog, we continue to expect our percentage growth in 2000 over 1999 will be in the low 40's." NC ¶ 67. Plaintiffs have alleged that there, in fact, was no such momentum and that there was no such strong order backlog. NC ¶ 76. *See In re APAC Teleservice, Inc. Secs. Litig.*, No. 97 Civ. 9145(BSJ), 1999 WL 1052004 at *8 (S.D.N.Y. Nov.19, 1999) ("Linking future success to present and past performance does not render statements immune from liability.").

3. Bespeaks Caution and Safe Harbor

Defendants argue that Nortel's forward looking statements and expressions of opinion were accompanied by suitable cautionary warnings and, therefore, are not actionable under the bespeaks caution doctrine, and that they enjoy "safe-harbor" protection under the Private Securities Litigation Reform Act ("PSLRA"). Def. Mem. at 9 ("Moreover, the guidance provided by Nortel to the investing public, as well as the expressions of opinion ... were all qualified with plentiful cautionary language."). Plaintiffs argue that Defendants' "generic warnings" were insufficient and failed to warn investors about the "undisclosed, adverse conditions" Defendants knew existed at the time they made the allegedly misleading statements. Def. Mem at 18-19 ("Defendants' generic warnings about potential negative economic trends 'beyond Nortel's control' did not alert investors to the undisclosed, adverse conditions then existing.").

[12] "Under the bespeaks caution doctrine, a misstatement or omission will be considered immaterial if cautionary language is sufficiently specific to render reliance on the false or omitted statement unreasonable." *In re Independent Energy Holdings PLC Secs. Litig.*, 154 F.Supp.2d 741, 755 (S.D.N.Y.2001). The cautionary language "must precisely address the substance of the

specific statement or omission that is challenged." *In re Prudential Sec. Inc. Ltd. Partnerships Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y.1996). "[N]o degree of cautionary language will protect material misrepresentations or omissions where defendants knew their statements were false when made." *Milman v. Box Hill Sys. Corp.*, 72 F.Supp.2d 220, 231 (S.D.N.Y.1999).

[13] The warnings that accompanied Nortel's public statements, press releases and SEC filings failed adequately to warn investors about existing conditions described (alleged) in the Nortel Complaint. For example, Nortel's SEC Form 10-K for fiscal year 1999 (also referred to in Nortel's press releases during 2000), talks of *629 "intense competition in the telecommunications industry, the highly volatile nature of the technology sector, and .. 'factors beyond Nortel Networks' control [including] ... adverse changes in the specific markets for Nortel Networks' products; the conditions in the broader market for communications ... and the conditions in the domestic or global economy generally.' " Def. Mem. at 10 (citation omitted). Plaintiffs do not complain about Nortel's failure to disclose generic risks. Plaintiffs allege Nortel failed to disclose negative consequences from specific risks that had either already come to pass or were known to be imminent, i.e. that public statements were made with actual knowledge that they were false or misleading. *See, e.g.*, NC ¶ 77 ("defendants had been informed by major customers prior to the close of the 2000 third quarter that their orders in the fourth quarter and throughout 2001 would be significantly reduced"); *see also Prudential*, 930 F. Supp. at 72 ("The doctrine of bespeaks caution provides no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away."). [FN15]

> FN15. With respect to vendor financing, "warnings of specific risks ... do not shelter defendants from liability if they fail to disclose hard facts critical to appreciating the magnitude of the risks described." *Credit Suisse First Boston Corp. v. ARM Fin. Group, Inc.*, 99 Civ. 12046(WHP), 2001 WL

> 300733, *8 (S.D.N.Y. Mar. 28, 2001). *See* Def. Mem. at 12 n. 14 ("Should [vendor financing] customers fail to meet their obligations, losses could be incurred and such losses may have a material adverse effect on the business, results of operations, and financial condition of Nortel Networks").

[14] [15] Under the safe-harbor provisions of the PSLRA, a statement regarding a forward looking statement generally does not give rise to a securities fraud claim if either: (i) it is accompanied by meaningful cautionary language, or (ii) the plaintiff fails to prove the statement was made with actual knowledge that it was false or misleading. *See* 15 U.S.C. § 78u-5(c).; *see also Independent Energy,* 154 F.Supp.2d at 755. However, "it is well recognized that even when an allegedly false statement 'has both a forwardlooking aspect and an aspect that encompasses a representation of present fact,' the safe harbor provision of the PSLRA does not apply." *APAC Teleservice,* 1999 WL 1052004 at *7 (quoting *Shaw v. Digital Equip. Corp.,* 82 F.3d 1194, 1213 (1st Cir.1996)). As noted *supra,* many of the allegedly misleading statements identified in the Nortel Complaint included recitations of historical facts. *See In re Complete Management Inc. Securities Litigation,* 153 F.Supp.2d 314, 340 (S.D.N.Y.2001) (noting that safe-harbor provisions "apply to forward-looking statements only, and not to material omissions or misstatements of historical fact"). Because the Nortel Complaint alleges that the Defendants had no basis for their optimistic statements and already knew (allegedly) that certain risks had become reality, the misstatements do not fall under the PSLRA's safe harbor provisions. *See Independent Energy,* 154 F.Supp.2d at 767.

C. Scienter

Defendants argue that "plaintiffs have failed to 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.' " Def. Mem. at 16 (quoting 15 U.S.C. § 78u-4(b)(2)). Plaintiffs respond that the Nortel Complaint alleges both

"motive and opportunity" to commit fraud and "facts that constitute strong circumstantial evidence of defendants' conscious misbehavior or recklessness by establishing that they knew facts or recklessly disregarded *630 information contradicting their public statements." Pl. Mem. at 13. [FN16]

> FN16. "Scienter is a necessary element of every 10b-5 action, and though it need not be plead with 'great specificity,' the facts alleged in the complaint must 'give[ ] rise to a "strong inference" of fraudulent intent.' " *In re Time Warner Inc. Secs. Litig.*, 9 F.3d 259, 268 (2d Cir.1993) (citations omitted). "A plaintiff can establish a strong inference of fraudulent intent in two ways: 'either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness.' " *Chill v. General Elec. Co.*, 101 F.3d 263, 267 (2d Cir.1996) (quoting *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir.1994)).

1. Motive and Opportunity

Defendants argue that "[f]ar from pleading motive and opportunity to commit fraud, the [Nortel] Complaint manages to negate any such motive." Def. Mem. at 17. Plaintiffs respond by saying: first, that because "Nortel's success was particularly and highly dependent upon making acquisitions to sustain its revenue and growth targets," the Company was "motivated" to maintain the market price of its shares, Pl. Mem. 11, and second, "Nortel could not have completed its February 8, 2001, $1.5 billion bond offering on the terms at which the bonds were sold had defendants first made truthful disclosures about Nortel's adverse financial condition." Pl. Mem. at 12.

Generally, motive "would entail concrete benefits that could be realized by one or more of the false statements

and wrongful nondisclosures alleged. Opportunity, would entail the means and likely prospect of achieving concrete benefits by the means alleged." *Shields,* 25 F.3d at 1130. "Motives that are generally possessed by most corporate directors and officers do not suffice; instead, plaintiffs must assert a concrete and personal benefit to the individual defendants resulting from this fraud." *Kalnit v. Eichler,* 264 F.3d 131, 139 (2d Cir.2001).

[16] It is unclear that motive is shown here. *See Leventhal v. Tow,* 48 F.Supp.2d 104, 115 (D.Conn.1999) ("Finally, the complaint alleges that the defendants had a motive to artificially inflate Citizens' stock price during the class period in order to get more favorable terms in the stock-for-stock transactions and in the issuance of the debentures. This motive is also insufficient to establish scienter and is routinely rejected by the courts."); *see also San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.,* 75 F.3d 801, 814 (2d Cir.1996) ("We do not agree that a company's desire to maintain a high bond or credit rating qualifies as a sufficient motive for fraud in these circumstances because '[i]f scienter could be pleaded on that basis alone', virtually every company in the United States that experiences a downturn in stock price could be forced to defend securities fraud actions.") (citation omitted). At the same time, the desire to consummate corporate transactions may in some instances "be a motive for securities fraud." *Rothman v. Gregor,* 220 F.3d 81, 93 (2d Cir.2000). In any event, the Court need not reach the question of motive, because Plaintiffs have sufficiently plead that Defendants knew or recklessly disregarded that their public statements were misleading.

2. Conscious Misbehavior or Recklessness

Plaintiffs argue that they have pled scienter by alleging "facts that constitute strong circumstantial evidence of defendants' conscious misbehavior or recklessness." Pl. Mem. at 13. Plaintiffs point, among others, to allegations that "Nortel's *631 problem were fundamental and should have been obvious to the Individual Defendants." Pl. Mem. at 13 citing NC ¶¶ 29- 31. The Nortel Complaint

alleges that the Defendants knew that many of the Company's largest customers were canceling orders and were planning to reduce orders in the coming years. *See, e.g.,* NC ¶ 85. Defendants respond that Plaintiffs fail to establish that "the executives responsible for the company's securities disclosures" had knowledge that the alleged misstatements were false. Def. Mem. at 19.

"To survive dismissal under the 'conscious misbehavior' theory, the [Plaintiffs] must show that they alleged reckless conduct by the [Defendants], which is at the least, conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.' " *Carter-Wallace,* 220 F.3d at 39 (citation omitted). "The facts alleged to support recklessness must be 'strong circumstantial evidence' of that recklessness." *Chill,* 101 F.3d at 269 (quoting *Acito v. IMCERA Group,* 47 F.3d 47, 52 (2d Cir.1995)) "[S]ecurities fraud claims typically have sufficed to state a claim based on recklessness when they have specifically alleged defendants' knowledge of facts or access to information contradicting their public statements. Under such circumstances, defendants knew or, more importantly, should have known that they were misrepresenting material facts related to the corporation." *Novak v. Kasaks,* 216 F.3d 300, 308 (2d Cir.2000).

Plaintiffs have adequately alleged that the Defendants either had actual knowledge of or ready access to facts that contradicted their public statements. "[P]rior to the close of the third quarter, Nortel senior management had been informed by ... major clients, including WorldCom and AT & T that orders in 2001 would be significantly reduced," NC ¶ 83; by the end of 2001, it was "common knowledge at Nortel ... that sales were headed for a 'serious decline.' " NC ¶ 143. Despite these negative developments, Plaintiffs allege that Defendants continued to issue positive statements regarding Nortel's outlook for of 2000 and 2001. The October 2000 Announcement stated that based on Nortel's "momentum" and "strong order backlog" the Company expected "percentage growth

in 2000 over 1999 will be in the low 40's." NC ¶ 67. The Nortel Complaint alleges that this statement was made despite the fact that "defendants had been informed by major customers prior to the close of the 2000 third quarter that their orders in the fourth quarter and throughout 2001 would be significantly reduced." NC ¶ 77. In the January 2001 Announcement, Roth said that "[o]verall the fourth quarter capped a year of exceptional growth, which was in line with our expectations." NC ¶ 153. The Announcement went on to quote Dunn as saying that Nortel was "projecting growth in revenues and earnings per share from operations in 2001 over 2000 of 30 percent." The Nortel Complaint alleges that these statements were false. *See* NC ¶ 161 ("the financial results reported for the fourth quarter and full year-end 2000 were materially misstated and presented in violation of GAAP"). "Defendants knew that '30 percent' growth in revenues and earnings per share in 2001 would not be possible because ... throughout the fourth quarter 2000, they received budgets from numerous customers indicating that their 2001 orders would be substantially below that of 2000. Indeed, Verizon's optical purchases were projected to be less than 10% of the $1.1 billion reported in 2000, and AT & T, WorldCom and other major customers submitted budgets for 2001 that were 20% *632 lower than that of 2000." *Id.* Plaintiffs sufficiently allege "defendants' knowledge of facts or access to information contradicting their public statements." *Carter-Wallace,* 220 F.3d at 40 (quotation omitted); *see also* NC ¶ 85 ("Nortel management were regularly provided with Equipment Inventory Reports for WorldCom and other major Nortel customers"); NC ¶ 84 ("Based on conversations with his customers in September 2000 [the Vice President of Global Sales for Nortel's High Performance Optical Group] submitted to defendant Chandran his group's fourth quarter 2000 sales forecasts, which were significantly lower than previously expected."); ¶ 161 ("throughout the fourth quarter of 2000, they received budgets from numerous customers indicating that their 2001 orders would be substantially below that of 2000"); *Chill,* 101 F.3d at 269 ("An egregious refusal to see the obvious, or to investigate the doubtful,

may ... give rise to an inference of recklessness.") (internal citations and quotations omitted).

V. Conclusion and Order

Defendants' motion to dismiss [61] is granted as to the JSDU Complaint [31] and denied as to the Nortel Complaint.

Counsel are requested to appear at a status/scheduling conference with the Court on January 29, 2003, at 3:00 p.m., in Courtroom 706 of the Thurgood Marshall Courthouse, 40 Centre Street, New York, New York. Any application to replead may be addressed at the conference. **The parties are directed to engage in good faith settlement negotiations prior to the conference with the Court.**

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING *EN BANC* OR BEFORE THE PANEL, JULY 14, 2004

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
THURGOOD MARSHALL U.S. COURTHOUSE
40 FOLEY SQUARE
NEW YORK 10007

Roseann B. MacKechnie
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, Foley Square, in the City of New York, on the 14th day of July two thousand four.

Weinstein, et al
Plaintiffs-Appellants

v

Nortel, et al
Defendants-Appellees

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellant Eli Weinstein, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED.**

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

For the Court,

Roseann B. MacKechnie, Clerk

By: /s/ A. Heller
Motion Staff Attorney
UNITED STATES COURT OF APPEALS
FILED JULY 14, 2004
ROSEANN B. MACKECHNIE, CLERK
SECOND CIRCUIT

RELEVANT PORTIONS OF STATUTES AND REGULATIONS

United States Code
Title 15. Commerce and Trade
Chapter 2B. Securities Exchanges
§ 78c. Definitions and application

(a) Definitions

When used in this chapter, unless the context otherwise requires--

* * *

(10) The term "security" means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

United States Code
Title 15. Commerce and Trade
Chapter 2B. Securities Exchanges
§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

* * *

b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

United States Code
Title 15. Commerce and Trade
Chapter 2B. Securities Exchanges
§ 78r. Liability for misleading statements

(a) Persons liable; persons entitled to recover; defense of good faith; suit at law or in equity; costs, etc.

Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

CODE OF FEDERAL REGULATIONS
TITLE 17--COMMODITY AND SECURITIES EXCHANGES
CHAPTER II--SECURITIES AND EXCHANGE COMMISSION
PART 240--GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934
SUBPART A--RULES AND REGULATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934
MANIPULATIVE AND DECEPTIVE DEVICES AND CONTRIVANCES

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

(3)

No. 04-487

Supreme Court, U.S.
FILED
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IN THE

Supreme Court of the United States

PETER S. VISNIC, MICHAEL GRYNBERG, LEROY HIBBITTS, SAJID KALEEM and PHILIP WEISBURGH, IRA,

Petitioners,

v.

NORTEL NETWORKS CORPORATION, JOHN ANDREW ROTH, WILLIAM F. CONNOR, CHAHRAM BOLOURI and FRANK DUNN,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR THE RESPONDENTS IN OPPOSITION

SHEARMAN & STERLING LLP
Stuart J. Baskin
Counsel of Record
Tai H. Park
Marc D. Ashley
Brendan N. Snodgrass
599 Lexington Avenue
New York, New York 10022
212-848-4000

Counsel for Respondents

QUESTION PRESENTED

Whether, under the private right of action implied by Section 10(b) and Rule 10b-5, shareholders of a public company have standing to sue another, unaffiliated issuer for securities fraud when the shareholders were neither purchasers nor sellers of that issuer's securities.

RULE 14.1 AND RULE 29.6 STATEMENT

The petition correctly lists the parties in the Court of Appeals.

Respondent Nortel Networks Corporation ("Nortel") is a publicly held corporation whose common shares are traded on the New York Stock Exchange and the Toronto Stock Exchange. Nortel is not a subsidiary of any parent company whose shares are publicly traded. In addition, securities issued by Nortel Networks Limited, a subsidiary company of Nortel, are traded on the Toronto Stock Exchange. No publicly held company owns 10 percent or more of the common shares of Nortel Networks Corporation.

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STATEMENT OF THE CASE

Plaintiffs put forth a vision of universal securities law standing. They argue that even though they never purchased or sold a single share of the securities of the issuer that ostensibly made false statements about its own financial condition and operations, they nonetheless have standing to sue as long as they purchased "any" security upon which the issuer's statements had some impact. Thus, a corporation can be sued not only by its own security holders, but also by shareholders of its suppliers, its customers, its banks, and even its competitors, provided that those shareholders allege that the offending corporation's statements impacted the trading price of those other companies' securities.

The Second Circuit's ruling rejecting universal standing and affirming the District Court's dismissal of plaintiffs' securities law claims comports both with this Court's well-established jurisprudence and the pertinent statutory language, and is wholly consistent with the only other Court of Appeals decision that touches on this issue. There is no reason for this Court to revisit a ruling so firmly grounded in bedrock principles of securities law.

A. Plaintiffs' Allegations

Nortel Networks Corporation ("Nortel") is a supplier of global telecommunications services. App. 3a.[1] JDS Uniphase Corporation ("JDSU") manufactures fiber optic components for sale to Nortel and other companies. App. 3a. Plaintiffs are purchasers of the common stock of JDSU. They never purchased or sold Nortel common stock. App. 5a.

---

[1] Citations to the Appendix ("App.") are to those materials appended to Petitioners' Petition for Writ of Certiorari ("Pet.").

On January 16, 2001, it was reported that Nortel and JDSU were close to consummating a transaction whereby Nortel would purchase JDSU's laser business in exchange for $2.5 billion of Nortel common stock. App. 4a. The transaction between Nortel and JDSU closed on February 12, 2001. App. 4a.

Between January 18, 2001 and February 15, 2001, Nortel made public statements that it saw strong demand for Nortel's fiber optics products and expected 30% growth in revenue and earnings in 2001. App. 4a. On February 15, 2001, however, Nortel announced that it was reducing its revenue growth projections from 30% to 15% and its revenue estimates by $1.7 billion. The market price of both Nortel and JDSU common stock declined following this announcement. App. 4a. Plaintiffs allege that the financial statements and press releases that Nortel made between January 18, 2001 and February 15, 2001 were materially misleading. App. 4a.

Following Nortel's revised guidance announcement on February 15, 2001, Nortel's stock price plummeted and, predictably, class action lawyers representing Nortel shareholders immediately began filing class action lawsuits against Nortel pursuant to Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. App. 5a. The Nortel shareholder lawsuits were consolidated and that case is currently being litigated. App. 5a.

Shortly after Nortel's February 15 announcement, however, there was an unprecedented additional development: on March 7, 2001, five individuals separately filed their own securities fraud actions against Nortel, ostensibly on behalf of a class of persons that purchased not Nortel securities but rather the common shares of JDSU (the "JDSU

Complaint"). App. 5a. The JDSU Complaint substantially tracks the complaint filed by Nortel shareholders, with the added twist that Nortel's fraud is alleged not only to have inflated Nortel stock, but JDSU's stock as well.

B. The District Court Proceedings

Nortel moved to dismiss the JDSU Complaint pursuant to Fed. R. Civ. P. 12(b)(6) for lack of standing and for failure to satisfy the "in connection with" requirement of Section 10(b) and Rule 10b-5. App. 5a. On January 3, 2003, the United States District Court for the Southern District of New York granted Nortel's motion and dismissed the JDSU Complaint with prejudice. App. 5a. The District Court, applying *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), and *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), held that shareholders of JDSU lacked standing to maintain a cause of action against Nortel because they had not purchased or sold a single share of Nortel stock. App. 5a. The District Court also dismissed the JDSU Complaint on the independently sufficient ground that plaintiffs could not, as a matter of law, satisfy the "in connection with" requirement because Nortel did not make any statement concerning JDSU. App. 5a. In dismissing the JDSU Complaint, the District Court rejected plaintiffs' theory of universal standing for any plaintiff who acquired some security and alleged that statements by an unrelated company had some impact on the trading price of that security.

C. The Second Circuit Proceedings

The Court of Appeals for the Second Circuit affirmed the District Court's dismissal of the JDSU Complaint with

prejudice on the ground that plaintiffs lack standing to maintain a cause of action under Section 10(b) and Rule 10b-5. App. 2a. The Second Circuit's opinion was guided by the principle that "the private right of action [under Section 10(b) and Rule 10b-5] is not unlimited." App. 7a. The Second Circuit considered and rejected plaintiffs' argument that universal standing exists whenever a plaintiff purchases "'*any security*' [which] includes securities of any company affected in some way by the misrepresentation and not just securities of the company that makes the material misstatements." App. 9a (emphasis added). The Second Circuit stated that plaintiffs' interpretation would subvert the purchaser-seller requirement established by this Court in *Blue Chip*, which "limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates." App. 10a (citing *Blue Chip*, 421 U.S. at 747).

The Second Circuit further concluded that this Court's concern, reflected in *Blue Chip*, that granting overbroad standing would "encourage individuals to engage in potentially abusive litigation" is particularly compelling here, where plaintiffs never purchased the security of the offending issuer. App. 10a. Based on this Court's standing jurisprudence and the relevant statutory language, and after considering (and distinguishing) purportedly conflicting Third Circuit precedent, the Second Circuit concluded that "[s]tockholders do not have standing to sue under Section 10(b) and Rule 10b-5 when the company whose stock they purchased is negatively impacted by the material misstatement of another company, whose stock they did not purchase." App. 13a. Plaintiffs' petition to the Second Circuit for rehearing by the panel or *en banc* was denied.

REASONS FOR DENYING THE WRIT

The Second Circuit's decision affirming dismissal of the JDSU Complaint for lack of standing (the "Opinion") is founded upon sound law and prudent policy. For almost 30 years since this Court's decision in *Blue Chip*, the private right of action created by Section 10(b) and Rule 10b-5 "limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates." 421 U.S. at 747. The decision below represents a straightforward application of this principle and the rejection of the notion of open-ended, universal standing. Plaintiffs' conjectural (and exaggerated) concerns about hypothetical plaintiffs being unjustly deprived of standing can be safely ignored.

I. The Second Circuit's Ruling Is Consistent With This Court's Jurisprudence and the Statutory Language

Although plaintiffs seek to characterize the Second Circuit's ruling as unprecedented, the Opinion is in fact fully consistent with this Court's venerable standing jurisprudence. Indeed, it is plaintiffs' own excessive theory of standing that is aberrant. This Court repudiated plaintiffs' expansive theory of Section 10(b) standing decades ago in *Blue Chip*. Plaintiffs have not provided (and cannot provide) this Court with any compelling justification for revisiting that decision. This is especially so where the Second Circuit correctly applied *Blue Chip* to preclude plaintiffs from suing Nortel where:

- Nortel only made statements about its own operations and financial condition;

- Plaintiffs did not purchase Nortel stock and only purchased JDSU stock;
- Nortel is not alleged to have directed any misrepresentations to JDSU shareholders; and
- Nortel was not affiliated with JDSU and made no tender offer to purchase JDSU shares from JDSU's shareholders.

These collective facts place this case squarely within the scope of this Court's *Blue Chip* decision. Plaintiffs seek to interpret *Blue Chip* broadly to create standing for any plaintiff that engages "in the mere act of purchasing or selling securities." Pet. at 8. Under plaintiffs' novel theory, the purchaser of *any* security would be entitled to sue *any* company.

Blue Chip forecloses the theory plaintiffs propose. In *Blue Chip*, this Court affirmed the purchaser-seller standing requirement first articulated by the Second Circuit in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952).[2] This Court held that persons who did not actually buy or sell securities (but rather claimed they chose not to buy because of deliberately false negative statements about a company) did not have standing to sue. To secure standing, a plaintiff must have bought or sold the security "in question," that is, the security to which the misrepresentation "relates":

> The virtue of the *Birnbaum* rule, simply stated, in this situation, is that it limits the class of plain-

[2] The standing requirement stems from the provision of Rule 10b-5 that a fraud or deceit must be "in connection with the *purchase or sale* of any security" (emphasis added).

> tiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates.

Blue Chip, 421 U.S. at 747.[3] The Second Circuit's ruling appropriately construes this passage to require that plaintiffs actually buy or sell the security to which the misrepresentation "relates"—here, Nortel (not JDSU) stock. This is also entirely consistent with this Court's unqualified statement elsewhere in *Blue Chip* that the *Birnbaum* rule "permits exclusion prior to trial of those plaintiffs who were not themselves purchasers or sellers of the stock in question." *Id.* at 742. The JDSU plaintiffs fall squarely into the category of such excluded nonpurchasers.

Plaintiffs' argument that the Opinion is inconsistent with the policies and principles established by this Court in *Basic Inc. v. Levinson,* 485 U.S. 224 (1988) (Pet. at 15-16), is also without merit. Both *Blue Chip* and the Opinion address the threshold issue of which stock purchasers have standing to bring a claim under the federal securities laws. *Basic*, in contrast, deals with the standard for pleading the reliance element of a Rule 10b-5 claim, an issue that arises only after a court has determined that the plaintiff has

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[3] Plaintiffs' denigration of this statement in *Blue Chip* as *dicta* (Pet. at 12)—and thus unauthoritative—is groundless. This Court's *Blue Chip* decision has much broader reach than the mere resolution of unique facts involved in that one case. Rather, the *Blue Chip* standing requirements are *always* a prerequisite to prosecution of a private securities claim. *See Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 277 (1992) (O'Connor, J., concurring) ("in *Blue Chip*, . . . we confirmed the federal courts' 'longstanding acceptance' of the rule that a plaintiff must have actually purchased or sold the securities at issue in order to bring a Rule 10b-5 private damages action") (citations omitted).

standing to bring a claim in the first place. Where, as here, plaintiffs lack standing to maintain a private right of action, whether they can sufficiently allege reliance as an element of their claim is beside the point.

After concluding that plaintiffs lack standing, the Second Circuit declined to reach the independent issue of whether plaintiffs could satisfy the "in connection with" requirement of a securities claim.[4] Despite the fact that the Second Circuit expressly did not reach the issue, plaintiffs boldly assert that the Opinion somehow "undermines an extensive body of Supreme Court and circuit court precedent interpreting" this component of Rule 10b-5. This extravagant assertion—based on out-of-context snippets of case law—is, like plaintiffs' standing argument, totally unfounded.

As is the case with plaintiffs' theory of universal standing, to accept their view of the "in connection with" requirement is to construe the securities laws as boundless. Under such a grandiose theory, different groups of plaintiffs who invested in different companies can all sue an unrelated issuer for securities fraud consistent with the "in connection with" requirement, provided that each plaintiff merely alleges that the issuer's statements—directly or indirectly, intentionally or unintentionally—had a "materi-

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[4] The District Court *did* reach the "in connection with" issue and concluded that, because Nortel had made no statement to JDSU shareholders or about JDSU, the "[requisite] connection [under Rule 10b-5] does not exist where, as here, the plaintiff does not allege that the defendant 'misled him concerning the value of the securities he [actually bought or] sold or the consideration he received in return.'" App. 29a (quoting *Saxe v. E.F. Hutton & Co.*, 789 F.2d 105, 108 (2d Cir. 1986)). Thus, the Second Circuit declined to reach an issue that the District Court had decided adversely to the plaintiffs.

al" impact on his company's stock price. Under the law, that result is untenable.

Clearly, courts within the Second Circuit (and elsewhere) have consistently interpreted the "in connection with" test so as to apply to misrepresentations that relate intentionally and directly to the securities bought and sold by the plaintiffs. *See, e.g., Pross v. Katz,* 784 F.2d 455, 459 (2d Cir. 1986) ("[T]he fraud alleged [must be] 'integral to the purchase and sale of the securities in question.'") (citation omitted); *Saxe v. E.F. Hutton & Co.,* 789 F.2d 105, 108 (2d Cir. 1986) (affirming dismissal of Section 10(b) claim because the alleged misrepresentations did not "concern[] the value of the securities he sold or the consideration he received in return"). That requisite connection between the alleged misrepresentations and JDSU stock is simply absent here.

Furthermore, despite plaintiffs' attempt to argue that the "in connection with" test is infinitely malleable, that requirement is not met simply by the mere allegation of materiality or impact unless a direct nexus between the defendant company and the plaintiffs is shown. For example, statements by a competitor about its own operations can impact an entire market segment. Yet no one has ever seriously suggested that another company's shareholders can sue that competitor for securities fraud. *See, e.g., Gershon v. Wal-Mart Stores Inc.,* 910 F. Supp. 128, 132 (S.D.N.Y. 1995) ("in connection with" requirement not satisfied in absence of nexus between defendant and market for plaintiffs' company's stock; "[t]he reach of Rule 10b-5 is not so extensive as to grasp all actors whose behavior has a negative impact on the market price of an issuer's securities").

The remedial purposes of Section 10(b) simply do not justify the highly attenuated and open-ended interpretations of standing and injury that plaintiffs urge this Court to adopt. *No* case has construed the "in connection with" requirement to permit a limitless array of claims based upon plaintiffs' assertion that an unrelated issuer's statements about itself had some material impact on their company's stock price.[5]

Finally, the Second Circuit appropriately rejected the strained argument that the phrase "any security" in Section 10(b) refers to "any company's securities." Rather, the phrase means "all types of securities," *i.e.*, stocks, bonds and debentures, as well as unregistered securities. App. 9a-10a.[6] The Second Circuit's sensible and straightforward ruling—that purchasers of the securities of one company have no standing to sue an unrelated company for alleged misstatements about itself—does not merit review.

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[5] Plaintiffs exploit generic language from inapposite cases to prop up their otherwise insupportable argument. For example, plaintiffs rely upon *SEC v. Zandford*, 535 U.S. 813 (2002), which permitted the Securities and Exchange Commission to enforce Section 10(b) against a securities broker who sold his client's securities and stole the proceeds. Obviously, *Zandford* involved facts and legal issues having nothing to do with this case. Indeed, with respect to effectuating Section 10(b)'s remedial purposes, parties with a direct action against Nortel—*i.e.*, Nortel shareholders—are already pursuing claims against Nortel.

[6] Although plaintiffs struggle to justify their creative reading of the statutory language, they acknowledge that the treatise the Opinion cites directly supports the Second Circuit's construction of that language. Pet. at 16.

II. The Second Circuit's Ruling Creates No Conflict With Any Other Court of Appeals

As an alternative basis for this Court's review, plaintiffs attempt to manufacture a conflict between the Opinion and the Third Circuit's decision in *Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000). Any such conflict is illusory.

As the Opinion explains, *Cendant* addresses a securities fraud claim within the context of a tender offer. App. 11a. The plaintiffs in *Cendant* purchased shares of a target company, after Cendant made a tender offer for the target company. App. 11a. Before the merger was completed, Cendant was forced to restate its financial statements and withdrew from the transaction. App. 11a. The target company's stock price fell, and plaintiffs (shareholders of the ultimately unacquired target) sued Cendant. App. 11a. After the district court dismissed the complaint, the Third Circuit remanded with instructions to evaluate whether the complaint met the "in connection with" requirement of a Rule 10b-5 claim. 223 F.3d at 178.

The Second Circuit's ruling that plaintiffs here lack standing cannot possibly be in conflict with *Cendant* because—as the Second Circuit itself noted—*Cendant* does not even address the standing issue. This hardly qualifies as a direct conflict. *See Bunting v. Mellen*, 124 S. Ct. 1750, 1752-53 (2004) (Stevens, J.).

Moreover, there is no conflict at all. The Second Circuit left "for another day" the question of whether *Cendant* was rightly decided in its interpretation of the "in connection with" requirement in the case of a merger. App. 12a. But, on the facts of this case, the court found that *Cendant* "is

easily distinguishable." App. 12a. Cendant had made a direct tender offer to purchase the target company's shares, and the Third Circuit remanded for consideration of whether this connection satisfied the "in connection with" requirement. By comparison, this case involves no tender offer, no offer to purchase, and no similar transaction that might provide, in the Second Circuit's words, a "direct relationship" that might satisfy the "in connection with" test. App. 12a.

In short, as the courts below concluded, persuasive authority is invisible to support an effort to stretch the definition of "in connection with" to reach a different company that made statements only about itself, had no interaction with plaintiffs,[7] and had neither intent nor reason to influence their company's stock price.

III. The Second Circuit's Ruling Will Deprive No Legitimate Plaintiff of Standing

Plaintiffs seek to justify the grant of certiorari by presenting a parade of unwelcome consequences that might be generated by the Second Circuit's ruling. Plaintiffs forecast that the Opinion will improperly bar numerous purchasers of stock from bringing lawsuits to impose Rule 10b-5 liability against various third parties that may have contributed to alleged fraud, as well as undermine the very integrity of the market. Pet. at 8. Plaintiffs' alarmist concerns are wholly unfounded.

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[7] To the extent that JDSU might be construed as having "purchased" Nortel's shares in selling its optical unit, that arguably afforded direct standing to JDSU, not its shareholders. JDSU, however, has not sued Nortel. JDSU's shareholders at most have a derivative claim against JDSU regarding its failure to sue Nortel, not a direct claim against the latter. App. 29a.

The simple fact is that the JDSU plaintiffs did not purchase shares of the stock about which the allegedly false or misleading statements were made. "Plaintiffs are purchasers of the common stock of JDSU" (Pet. at 1), while the allegedly misleading statements made by Nortel were "positive statements concerning *Nortel's* operations and prospects" (Pet. at 2) (emphasis added). The practical impact of the Opinion will not be to handicap legitimate securities plaintiffs, but rather to confine plaintiffs to seeking relief only for misstatements made about securities that they actually purchased.

Thus, if a broker lies to a customer about stock X and the customer buys stock X, nothing in the Opinion speaks to that customer's standing to pursue a claim against the broker. Similarly, the Second Circuit has recognized that brokers, accountants, underwriters and banks may indeed be held liable under Rule 10b-5 for statements made regarding a security other than their own; nothing in the Opinion will alter that law. The only requirement is that the class of putative plaintiffs must be limited "to those who have at least dealt in the security to which the . . . representation or omission relates." App. 10a (citing *Blue Chip*, 421 U.S. at 747).[8]

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[8] It is only through plaintiffs' own strained construction of the Opinion that the specter of unfairly precluding various types of legitimate lawsuits arises. The phrase "material misstatement of another company" (App. 13a) in the Second Circuit's holding is properly construed to mean a material misstatement *regarding* another company, as opposed to plaintiffs' view that it refers to a material statement *issuing from* another company. Of course, under either reading, plaintiffs here are properly deprived of standing.

Certiorari is therefore not warranted to resolve plaintiffs' speculative and hyperbolic concerns, which are purely a red herring. Here, plaintiffs are, indisputably, "nonpurchasers" of the Nortel stock to which the alleged misstatements relate, and thus they clearly lack standing to pursue their claim against Nortel.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

Stuart J. Baskin
Counsel of Record
Tai H. Park
Marc D. Ashley
Brendan N. Snodgrass
SHEARMAN & STERLING LLP
599 Lexington Avenue
New York, New York 10022
(212) 848-4000

Counsel for Respondents

Supreme Court, U.S.
FILED
NOV 22 2004
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No. 04-487

IN THE

Supreme Court of the United States

PETER S. VISNIC, MICHAEL GRYNBERG, LEROY HIBBITTS, SAJID KALEEM AND PHILIP WEISBURGH, IRA,

Petitioners,

NORTEL NETWORKS CORPORATION, JOHN ANDREW ROTH, WILLIAM F. CONNOR, CHAHRAM BOLOURI AND FRANK DUNN

Respondents.

On Petition for Writ of Certiorari
To The United States Court of Appeals
For The Second Circuit

REPLY TO BRIEF IN OPPOSITION

James P. Bonner
Shalov, Stone
& Bonner, LLP
485 7th Ave., #1000
New York, NY 10008
(212) 239-4350

Dennis J. Johnson
Counsel of Record
Johnson & Perkinson
1690 Williston Road
S. Burlington, VT 05403
(802) 862-0030

Attorneys for Petitioners

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Blue Chip Stamps v. Manor Drug Store,
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I. INTRODUCTION

Unable to deny the demonstrable effect Defendants' statements had on the market price of the JDS Uniphase ("JDSU") securities purchased by Plaintiffs and, thus, Plaintiffs' ability to satisfy the Second Circuit's test for "in connection with" pronounced in *In re Ames Dept. Stores, Inc., Stock Litig.* 991 F.2d 953 (2d Cir. 1993) (in an efficient market, defendants' statements are in connection with plaintiffs' purchases if they were material to such investors), Defendants sold the lower courts a suit woven of invisible cloth.

Defendants induced the lower courts to ignore this Court's holding in *Blue Chip Stamps v. Manor Drug Store,* 421 U.S. 723 (1975), that the mere act of purchasing or selling the security at issue confers standing and, instead, to focus on what was expressly pronounced by this Court to be its *dicta* applying that holding to the facts of that case. As Plaintiffs repeatedly brought to the lower courts' attention, *Blue Chip* firmly establishes Plaintiffs' standing and no court has ever read *Blue Chip* in the manner advocated by Defendants. Defendants fictitiously responded, as they do in their Brief in Opposition ("Def. Brief"), by accusing Plaintiffs of attempting to broaden the holding of *Blue Chip*, terming the rule of law pronounced therein "universal standing" and attributing it to Plaintiffs.

When Plaintiffs urged the lower courts to apply the unambiguous text of Section 10(b), which dictates that the statute applies whenever a plaintiff purchases or sells "any security," Defendants, as they do in their Brief, accused Plaintiffs of seeking to rewrite the statute. Nothing could be further from the truth. Plaintiffs urged the courts to accept the obvious: "any" means any. At Defendants' behest, it was the Second Circuit which rewrote this statute, limiting "any" to any type of security issued by the company which issued the challenged statements. In doing so, it violated a longstanding principle of statutory construction requiring the courts to strictly apply such unambiguous congressional directives.

The denial of standing in this case cannot be squared with *Semerenko v. Cendant Corp.*, 223 F.3d 165, 176 (3d Cir. 2000) because *Semerenko* presumed the plaintiffs' standing and, instead, analyzed defendants' potential liability in the context of the "in connection with" component of Section 10(b). In their Brief, Defendants merely recite that, in *Semerenko,* there was a tender offer while here there was not. This factual distinction is without legal significance since it begs the question of whether Defendants' statements deceived Plaintiffs, or, stated differently, whether their statements artificially inflated the price of the JDSU securities Plaintiffs purchased. Furthermore, this factual distinction does not permit or justify the lower courts' refusals to heed this Court's prior pronouncements that even statements issued in the context of a speculative tender offer (or one never completed, as was true in *Semerenko)* may be material to investors in the securities of the proposed target company. *Basic, Inc., v. Levinson,* 485 U.S. 224, 236 (1988); *see also Semerenko,* 223 F.3d at 177. This is true even though the target company did not issue those statements. Moreover, this factual distinction rings pale when one considers that Defendants misrepresented the value of an undeniably material asset (65 million shares of Nortel stock supposedly worth $2.5 - $3.0 billion) which was to be, and did get, transferred to JDSU by Nortel. The consummation of this transaction renders its nexus to Plaintiffs' purchases even closer than the *Semerenko* plaintiffs were to the aborted tender offer in *Semerenko.*

Finally, now that Plaintiffs' Petition notes the harms inherent in the application of the Opinion and demonstrates that the Second Circuit's policy concerns regarding vexatious litigation have never come to fruition notwithstanding the passage of thirty of years since *Blue Chip,* Defendants accuse Plaintiffs of raising "speculative" and "hyperbolic" concerns. Effectively asking this Court to acknowledge the invisible suit woven by Defendants in the lower courts, they now urge this Court to ignore the clear import and holding of the Opinion.

II. ARGUMENT

A. The Opinion Conflicts With This Court's Prior Determinations Of Standing.

Defendant's Brief makes clear what is undeniable: prior to the Opinions issued below, *no* court, in the thirty years since *Blue Chip* was decided, has held that a plaintiff who purchases the very security at issue or in question in their claims lacks standing. While Defendants assert that "[t]his Court repudiated Plaintiffs' expansive theory of Section 10(b) standing decades ago in *Blue Chip*", Def. Brief, p.5, in actuality, *Blue Chip* expressly and repeatedly confirms Plaintiffs' standing to bring the claims presented in this case. *Blue Chip* held that, in order to have standing, a plaintiff merely need purchase or sell "a security", "securities", the "security in question", or the security "at issue". Plaintiffs' Petition for Writ of Certiorari, pp. 9-10 ("Petition"). Thus, *Blue Chip* repeatedly interpreted Section 10(b) to permit what Defendants now euphemistically dub an "aberrant theory of universal standing." Def. Brief, pp. 3, 5. Far from seeking to expand *Blue Chip's* holding, Plaintiffs seek merely to rectify the lower courts' errors in failing to apply that holding. The security at issue or in question in Plaintiffs' claims is JDSU common stock, which was purchased by Plaintiffs and all other members of the Class. The Opinion improperly shifts the focus of standing from Plaintiffs' claims to the type of defendant issuing the statements artificially inflating the securities purchased by Plaintiffs.

In applying its holding to the facts at hand, *Blue Chip* pronounced that "[t]he virtue of the *Birnbaum* rule, simply stated, *in this situation*, is that it limits the class of plaintiffs to those who have at least dealt in the securities to which the prospectus, representation, or omission relates." *Blue Chip*, 421 U.S. at 747 (emphasis added). *Blue Chip* does not in any way, shape or form suggest that its holding, that a plaintiff has standing if he/she purchases securities (rather than merely holds or refrains from purchasing or selling securities), was

modified by the application of that holding to the facts at hand. Defendants themselves acknowledge that the Supreme Court's decisions have a "much broader reach than the mere resolution of unique facts involved in that one case." Def. Brief, p. 7, ftnt. 3. Thus, contrary to Defendants' assertion that "[t]he Second Circuit's ruling is firmly grounded in bedrock principles of securities laws," Def. Brief, p.1., the Opinion is actually grounded on the Second Circuit's inaccurate finding that *Blue Chip's dicta* cited above was its holding. It bears repeating that no court has ever come to the same conclusion.

Defendants' suggestion that Plaintiffs, who purchased the very stock at issue in their claims, are nonetheless "nonpurchasers" within the purchaser-seller standing requirement first pronounced in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), is utterly devoid of *any* support, at direct odds with *Blue Chip's* actual holding, and wholly unsupported by *Blue Chip's* analysis of the vagaries of proof which would present themselves if those who engage in no transactions were permitted to bring Section 10(b) claims. Plaintiffs' purchases of JDSU stock are the exact type of demonstrable proof which *Blue Chip* held eliminates such vagaries. Neither *Birnbaum* nor *Blue Chip* hold that a plaintiff's standing is determined by examining whether plaintiff purchased the securities of the company which issued the challenged statements.

In fact, the Second Circuit did *not* find that Plaintiffs lacked standing because Defendants' statements did not relate to JDSU stock. Instead, it held that Plaintiffs lacked standing because the material statements which artificially inflated the stock purchased by Plaintiffs were not issued by the company whose stock Plaintiffs purchased. App. 13a. An analysis of whether Defendants' statements "relate[d]" to JDSU or its stock would have ineluctably led to an affirmative conclusion since those statements not only had a demonstrable effect on JDSU's stock price, but also, on occasion, specifically

referenced JDSU and the Laser Business transaction.[1] In fact, the Opinion's holding accepts the materiality of Defendants' statements to the securities purchased by Plaintiffs. App. 13a.[2]

B. The Second Circuit Inappropriately Rewrote Section 10(b).

Section 10(b) unambiguously confers standing on purchasers or sellers of "any security." Contrary to Defendants' assertions, Plaintiffs' reading of this statute is anything but "creative," nor do Plaintiffs seek to rewrite this statutory directive. Instead, it was the Second Circuit that did so by limiting the scope of the statute to any type of security of the company issuing the challenged statements. Def. Brief, p. 10. As this statutory language makes clear, "any" means any.[3] A plaintiff has standing under Section 10(b) whether he purchases any type of

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[1] Of course, an examination of the nexus between the content of Defendants' statements and the security purchased by Plaintiffs is exactly what the "in connection with" analysis is about.

[2] *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 277 (1992) (O'Conner, J. concurring), cited by Defendants for the proposition that "in *Blue Chip*, . . . we confirmed the federal courts' 'longstanding acceptance' of the rule that a plaintiff must have actually purchased or sold the securities at issue in order to bring a Rule 10b-5 private damages action," clearly supports Plaintiffs' standing. In *Holmes*, the plaintiff was neither a purchaser nor a seller of securities. Thus, the Court held merely that the plaintiff, an insurer of investors' funds, was only indirectly injured by the defendants' conduct and, therefore, could not maintain a RICO claim because it could not establish the causation element of such a cause of action. *Id.* at 270. Plaintiffs' purchases of JDSU stock distinguish them from the plaintiff in *Holmes* and make them persons *directly* affected by Defendants' misrepresentations.

[3] Equally fanciful is Defendants' assertion that Plaintiffs "acknowledge that the treatise the Opinion cites directly supports the Second Circuit's construction of that language." Def. Brief, p. 10. ftnt. 6. In reality, Plaintiffs pointed out how that treatise offered no support for the Court's narrow reading of the term "any." Petition, p. 16, ftnt. 10.

security *or* any company's securities. While courts are obligated to strictly apply unambiguous statutory directives, the Second Circuit was only able to issue the Opinion by inappropriately rewriting the unambiguous text of Section 10(b).

C. The Opinion Undermines This Court's Prior Interpretations Of Section 10(b) And The Connection with Component of that Statute.

Although Plaintiffs' Petition merely recites this Court's and the Second Circuit's prior holdings on the scope of the "in connection with" component of Section 10(b), Defendants accuse Plaintiffs of offering a "grandiose," "unfounded" and "untenable" theory of "in connection with." As Plaintiffs' Petition demonstrates, the Opinion sharply conflicts with this Court's prior opinions: (a) interpreting Section 10(b) generally, finding that it is not to be interpreted technically and restrictively, but flexibly to effectuate its remedial purposes and to implement a policy of full disclosure; and (b) specifically interpreting the "in connection with" component of Section 10(b), found to be satisfied whenever defendant's conduct touches plaintiff's purchase or sale of securities. Petition, p. 17-18. Additionally, the Opinion undermines *Ames,* which holds that, in an efficient market, defendants' statements are "in connection with" plaintiffs' purchases if they are material to plaintiffs. *Ames*, 991 F.2d at 964. Even though defendants' conduct or statements may be demonstrably "in connection with" plaintiffs' purchases, as is the case here, in the Second Circuit, whole categories of plaintiffs will never be able to reach the issue, since they will be denied standing based on the defendants' status. The Opinion allows defendants to accomplish indirectly (through standing) what this Court has precluded them from doing previously (by broadly reading the "in connection with" component of Section10(b)) and thereby undermines decades of Supreme Court and appellate court precedent.

Seeking to conceal the open conflict between the Opinion and this Court's prior pronouncements on "in connection with," Defendants argue that liability under Section 10(b) only exists if Defendants' misrepresentations "relate intentionally and directly to the securities bought and sold by the Plaintiffs." Def. Brief, p. 9.[4] First, whether Defendants intentionally sought to inflate JDSU's stock by issuing their misrepresentations is irrelevant. *See, e.g., Semerenko*, 223 F.3d at 176; *Ames*, 991 F.2d at 965. As these opinions demonstrate, that Defendants' statements caused the artificial inflation in the shares purchased by Plaintiffs is sufficient to satisfy the "in connection with" requirement.

Second, the cases cited by Defendants offer no support for their position. As the *Ames* court recognized, in *Pross. v. Katz*, 784 F.2d 455 (2d Cir. 1986), the fraudulent conduct at issue occurred *after* the *transaction* and, therefore, could not be "in connection with" the plaintiffs' purchases. *Ames*, 991 F.2d at 966. ("The key to [*Pross*] is that the fraud followed the securities transaction.) Similarly, the conduct at issue in *Saxe v. E.F. Hutton & Co.*, 789 F.2d 105 (2d Cir. 1986) did not permit a finding that Section 10(b)'s "in connection with" requirement was satisfied under any test because the case involved claims that should have been brought under the Commodities Exchange Act. *Saxe*, 789 F.2d at 108-09.

Neither Defendants nor the lower courts referenced *any* case finding that material representations issued to an efficient market and inflating the securities

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[4] Defendant's effort to gain support by noting that the district court also found that Defendants' statements were not in connection with Plaintiffs' purchases is certainly curious. The lower court based its conclusion on its finding that Defendants' statements did not go to the value of the securities purchased by Plaintiffs, a test specifically rejected by this Court (even prior to the district court's opinion) in *S.E.C. v. Zandford*, 535 U.S. 813 (2002). Moreover, the district court wholly ignored an abundance of evidence confirming that, in light of the initially pending and subsequently finalized Laser Business transaction between JDSU and Nortel, Defendants' statements clearly affected the value of the JDSU stock purchased by Plaintiffs.

purchased by Plaintiffs failed to satisfy the "in connection with" requirement or that Plaintiffs lacked standing to sue because those statements were not issued by the company whose securities the plaintiffs purchased. Certainly *Gershon v. Wal-Mart Stores*, 901 F. Supp. 128 (S.D.N.Y. 1995) offers no support for either proposition. In *Gershon*, the defendants made *no statements*. *Id.* at 131. As a result, the defendants engaged in no fraudulent conduct that could satisfy the "in connection with" requirement because they had no duty to disclose that Wal-Mart had a policy of discontinuing purchases from venders found guilty of customs violations. *Id.* If anything, *Gershon* demonstrates that the courts are already more than able to determine those situations when plaintiffs overstep the legitimate boundaries of "in connection with" and that the rule of law pronounced in the Opinion, with all its potential ill effects, is unnecessary.

D. The Opinion Creates An Untenable Conflict With The Third Circuit's *Semerenko* Decision.

Defendants' position that *Semerenko* is not in conflict with the Opinion is illusory. The Third Circuit did not discuss standing because, prior to this case, no Court had ever found that a plaintiff who purchased the security at issue in his claims lacked standing. The nakedness of Defendants' assertion that *Blue Chip* provides the basis for such a conclusion is demonstrated not just by the argument that the Third Circuit, in *Semerenko*, supposedly overlooked this purportedly pivotal issue, but also by the fact that hundreds of courts over the last three decades supposedly did the same. Yet, to accept Defendants' position requires one to adopt this wholly implausible proposition.

Applying the rule of law announced in the Opinion would preclude liability under the facts present in *Semerenko* since plaintiffs, purchasers of ABI stock, would be precluded from suing Cendant, given that plaintiffs did not buy Cendant stock. While the Second Circuit attempted to backpedal from the application of its own

holding, there is no indication of why or how the Opinion leaves room for doing so. The Second Circuit's holding, that plaintiffs "do not have standing to sue under Section 10(b) and Rule 10b-5 when the company whose stock they purchased is negatively impacted by the material misstatement of another company, whose stock they did not purchase," App. 13a, leaves no room for an analysis of the nexus between Defendants' statements and Plaintiffs' purchases. Moreover, this analysis, which is supposed to occur in the context of determining whether defendants' statements were "in connection with" plaintiffs' purchases, would have confirmed Plaintiffs' standing given the direct, immediate and dramatic effect of Defendants' statements on the market price of JDSU stock.

E. The Opinion Threatens To Undermine The Integrity Of The Securities Markets.

The rule of standing set forth in the Opinion not only unjustly renders Plaintiffs collateral damage under the federal securities laws, but also bars many classes of plaintiffs who, until now, were free to present claims that various defendants' statements artificially inflated the securities they purchased. Plaintiffs' Petition provides numerous examples of the types of plaintiffs who now may be found to lack standing and the types of defendants, depending on the circumstances, which now enjoy immunity under Section 10(b). Defendants' attempt to limit the effect of the Opinion by rewriting its holding (that standing exists if the *dicta* in *Blue Chip* is satisfied) is legally untenable, at odds with the Court's actual holding, App. 13a., and ignores the fact that the Second Circuit, while holding that the district court's analysis of the issue was flawed, made no effort to determine if Defendants' statements related to JDSU stock. Had the Second Circuit undertaken this analysis, Plaintiffs' standing, even under this test, would have been clear. See Petition, pp. 2-6. In fact, Defendants never denied that their statements were material to JDSU investors and the Opinion accepts that fact. App. 13a.

The Second Circuit acknowledges that the Opinion is premised on the policy concern that permitting the Plaintiffs to proceed would open a floodgate of litigation. There is *no* proof that this is so. *See* Petition pp. 20-22. In fact, while Plaintiffs found just a handful of situations wherein some unique nexus between two companies permitted Plaintiffs to bring claims that statements by one of the companies artificially inflated the market price of the other company's securities, Defendants have now cited *one* case which is close to being on point, *Gershon*. The *Gershon* opinion, however, confirms that the courts are more than able to detect and dismiss those cases wherein plaintiffs baselessly allege that a defendant's statements were in connection with plaintiffs' purchases. As the Second Circuit's policy concern is illusory, there is no justification for denying whole categories of investors their constitutional right to enjoy the protections of the federal securities laws.

III. CONCLUSION

Consistent with this Court's prior opinions broadly interpreting Section 10(b) so as to protect the integrity of the markets and promote a philosophy of full disclosure, Plaintiffs respectfully request that this Court grant their Petition.

Respectfully submitted,

Dennis J. Johnson
Counsel of Record
Johnson & Perkinson
1690 Williston Road
S. Burlington, VT 05403
(802) 862-0030
Attorney for Petitioners